

# Future of GST administration in India: Analysis for Key States

Final Report

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Contract No. 40128430



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## List of Acronyms

Acronym	Full form
AUD	Australian Dollar
ARM	Additional Resource Mobilisation
B2B	Business to Business
BIFA	Business Intelligence and Fraud Analytics
BE	Budget Estimate
CAD	Canadian Dollar
C&AG	Comptroller and Auditor General
CBIC	Central Board of Indirect Taxes & Customs
CBDT	Central Board of Direct Taxes
CG	Central Government
CGST	Central Goods & Services Tax
CTD	Commercial Tax Department
DE	Development Expenditure
DGARM	Directorate General of Analytics and Risk Management
DGFT	Directorate General of Foreign Trade
E- FPBs	Electronic Focal Point Branches of Authorized Banks
EHTP	Electronic Hardware Technology Park Unit
EOU	Export Oriented Unit
EPCG	Export Promotion Capital Goods
EWB	Electronic way bill
FY	Financial Year
GBP	British Pound Sterling
GDP	Gross Domestic Product
GSDP	Gross State Domestic Product
GST	Goods & Services Tax
GSTN	Goods & Services Tax Network
GTA	Goods Transport Agency
HMRC	Her Majesty's Revenue and Customs

<b>Acronym</b>	<b>Full form</b>
IGST	Integrated Goods & Services Tax
INR	Indian Rupees
ISD	Input Service Distributor
ITC	Input tax credit
KYC	Know Your Customer
Mn	Million
MOC	Ministry of Commerce
MOSPI	Ministry of Statistics and Programme Implementation
MSME	Micro, Small and Medium Enterprises
NAAAR	National Appellate Authority of Advance Ruling
NACIN	National Academy of Customs, Indirect Taxes & Narcotics
NFHS	National Family Health Survey
OIDAR	Online Information Database Access and Retrieval service
OTP	One time password
POS	Place of supply
QRMP	Quarterly Returns Monthly Payment
RBI	Reserve Bank of India
RC	Registration Certificate
RE	Revised Estimate
RR	Revenue Receipts
RUP	Revenue Under Protection
SCN	Show Cause Notice
SDG	Sustainable Development Goals
SEZ	Special Economic Zone
SG	State Government
SGST	State Goods & Services Tax
SOTR	State's Own Tax Revenue
STP	Software technology park
TDS	Tax deducted at source

<b>Acronym</b>	<b>Full form</b>
TPRU	Tax Policy Research Unit
TR	Total Revenue
TRP	Tax Return preparer
UT	Union Territory
UTGST	Union Territory Goods & Services Tax
VAT	Value-added Tax



30th June 2022

To

**Abhirup Dasgupta**

Head of Ease of Doing Business Programme  
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**Subject:** Submission of Final Technical Report under the Project "Contract No. 40128430, Future of GST administration in India: Analysis for Key States"

Dear Abhirup,

We are pleased to submit the Final Technical Report under the Project "Future of GST administration in India: Analysis for Key States".

We would be willing to provide any further information and clarification you may seek related to this submission.

Yours faithfully,

A handwritten signature in blue ink that reads "Manoranjan Pattanayak".

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# Executive Summary

Goods and Services Tax (GST), one of the biggest reforms in indirect tax structure of India, was rolled out on 1<sup>st</sup> July 2017 after nearly a decade of intense deliberations. Globally, some form of GST is prevalent in nearly 160 nations, including in the European Union and some Asian countries. A key differentiation in the way GST has been adopted in India is that India follows a dual GST levy system. This new federal GST regime aimed to balance the need for a common and uniform tax structure across states with the revenue generating powers enshrined in the Constitution of India to the Centre and the States. The administration of GST has undergone several updates over the years to simplify the tax regime and improve administrative efficacies. While this GST regime was maturing, the Government of India agreed to compensate states if their revenue collections were less than an agreed level of 'revenue under protection', for a period of five years, i.e., till June 2022 under the Goods and Services Tax (Compensation to States) Act 2017. This 'revenue under protection' was meant to cushion the revenue shock from the replacement of sales tax/VAT and other taxes which were levied and collected by States. It was assumed that under normal conditions, states would register a 14% growth annually over subsumed taxes collected in 2015-16<sup>1</sup>.

Discontinuation of GST Compensation Cess<sup>2</sup> post June 2022 is expected to lead to substantial revenue loss to states which, in turn, will severely impact development spending at the State level. This will have implications on India's achievement of Sustainable Development Goals (SDG), the progress of which is significantly contingent on state-level efforts in India. It further risks undermining the spirit of competitive federalism which the Government of India is encouraging, while remaining an open economy.

This study aims to detail the current GST process to establish the ease of transactions and bottlenecks for businesses in India. Further, it aims to assess the revenue shortfall in select states due to compensation cessation, and its resulting impact on development spending. The Study is based on extensive data analysis to estimate revenue shortfall and impact on development spending supplemented with consultations with Government of Haryana, select private sector companies and industry associations on key challenges faced in GST administration.

The study is divided into two workstreams:

- **Workstream 1** details the current GST assessment, collection, refund, and compensation route in India, starting from a taxpayer through to Central Government and back. This workstream also demonstrates the time and cost of compliance under the current tax administration regime and key challenges faced by taxpayers.
- **Workstream 2** aims to understand (i) the expected trend in GST collections for different states, and (ii) its impact on overall state finances, development spending as the GST architecture further matures. For the study, the three states selected for conducting the quantitative and impact analysis are Haryana, Karnataka, and Tamil Nadu. The selection of states allows for an inclusive geo-political spread across the country. These states also reflect a high footprint of British businesses and Deputy High Commission offices.

It was found that with the removal of the compensation cess from June 2022, the three states are expected to have a revenue shortfall during the period 2022-23 (July-March) to 2026-27. The shortfall is calculated from the revenue they would have received had the states been under protection in the period after June 2022. The study also estimated that the impact of this shortfall will reduce development expenditure of the states in the range of 2.3% - 3.6%, thereby affecting socioeconomic outcomes. This shortfall can be addressed with an increase in tax buoyancy (i.e., percentage change in tax collections with one percentage change in tax base, i.e., Gross Domestic Product in this case) of the states. It was found that an increase in tax buoyancy, the shortfall in revenue can be mitigated faster in the years to come. To increase the tax buoyancy, the study has recommended methods

to strengthen the tax administration including the easing of compliances for taxpayers, increasing the capacity of officers, and enhancing administrative efficiency in detail.

The structure of this report is as follows. Chapter 2 outlines the methodology followed and Chapter 3 sheds light on the introduction of GST in India, how India's GST regime compares with other jurisdictions and a mapping of the GST compliance flowchart and challenges faced at each stage. Chapter 4 delves into the fiscal situation of the three selected states – Karnataka, Haryana, and Tamil Nadu, estimates the projected GST revenue collection and shortfall and includes a quantitative assessment of the impact of the shortfall on development expenditure. Chapter 5 includes potential collaboration opportunities where the expertise of the UK Government can be leveraged to further strengthen India's GST administration and concludes with recommendations to use alternative tools and mechanisms to improve tax administration through the lens of reducing compliance burden, enhancing the tax base, reducing tax evasion, etc. The report seeks to identify areas for improvement along with opportunities for the UK Government to engage at the State and Centre level on their respective GST regimes going forward. The recommendations were broadly classified into three categories - easing compliances for the taxpayer, institutional capacity building, and enhancing administrative efficiency.

PwC India would like to acknowledge the Foreign, Commonwealth and Development Office team for the opportunity to conduct this study, their support at multiple junctures, and constantly providing appropriate feedback to strengthen the study.

# 1. Introduction

## 1.1. Setting the Context

Goods and Services Tax (GST), one of the biggest reforms in indirect tax structure of India, was rolled out on 1<sup>st</sup> July 2017 after nearly a decade of intense deliberations. GST replaced a structure which featured cascading nature of taxes, complexities in tax administration, high compliance cost for businesses, and limited jurisdiction of state governments to tax the services sector. GST was also intended to help relieve the tax burden on exporters, thereby making exports more competitive globally. GST also made domestic goods competitive by removing the cascading effect of taxes in the entire supply chain. At the time of GST implementation, the most definitive study funded by the 13<sup>th</sup> Finance Commission on the impact of GST on India's International Trade estimated that a comprehensive GST regime was expected to increase gross domestic product (GDP) growth in the range of 0.9-1.7 percentage points and would make the domestic industry more competitive<sup>1</sup>.

The introduction of GST required the resolution of complex issues such as which taxes to subsume, acceptable rate of GST for both centre and states and most importantly the compensation mechanism if there were revenue losses to the states due to transition to GST from VAT regime. To address the latter issue, the Government of India agreed to compensate states if their revenue collections were less than an agreed level of protected revenues, for a period of five years, i.e., till June 2022. The 'revenue under protection' was set assuming that in normal conditions, states would register a 14 percent growth annually over 2015-16 in subsumed taxes under GST<sup>2</sup>. Any deficit in tax collection would be funded through the GST Compensation Fund. This fund, in turn, would be financed through a cess on goods designated as sin or luxury goods. Over the years, especially with the onset of pandemic, the actual collections have substantially deviated from the projected growth rate of 14 percent. This implied a case for larger compensation to States. The corpus in GST compensation fund, which was also linked to tax base, has not been sufficient to fully compensate states. This has delayed the transfer of GST compensation from Centre to states in the last two years.

## 1.2. Objective and Scope of Work

As the compensation period is expected to end by June 2022<sup>3</sup>, it is important to understand (i) the expected trend in GST collection for different states and its impact on state finances, development spending as the GST architecture further matures, (ii) where states and centre can both work together, as well as individually, to enhance tax collections while reducing compliance burden and achieve overall economic growth, and (iii) identify the key challenges and opportunities for the UK Government and businesses to engage at the state level in the post June 2022 GST regime. With this context, the objective of this report is to:

- a) enhance the understanding of GST regime for the Government of United Kingdom and UK businesses operating in India.
- b) understand the next phase of GST administration reforms in India (post-June 2022) in the context of the state revenue shortfall due to the withdrawal of the compensation.

The scope of the work is categorised across two workstreams:

### Workstream 1: GST Flowchart

The objective of this workstream is to develop a GST flowchart, i.e., GST assessment, collection, refund, and compensation route in India starting from a taxpayer through to Central Government and back, covering all

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<sup>1</sup> NCAER (2009): "Impact of Goods and Services Tax on India's International Trade", Thirteenth Finance Commission, New Delhi.

<sup>2</sup> The Goods and Services Tax (Compensation to States) Act (<https://cbic-gst.gov.in/compensation-cess-bill-e.html>)

<sup>3</sup> The GST Council, in its ensuing meeting in May 2022 is expected to take a call on the demands from most State Govts about the continuation of the payment of compensation for a few more years, including alternative options in the event of its discontinuation. This decision may have a significant bearing on this report as it is currently prepared.

touchpoints, stakeholders, costs, and timelines. It also includes stakeholder consultations to understand on-ground challenges faced by business taxpayers and state governments.

**Workstream 2: Impact Estimation**

Under this workstream, report estimates the potential revenue shortfall (for selected three states) till 2026-27. The report further estimates the impact of revenue shortfall on development spending.

Based on workstream 1 and workstream 2, the report recommends potential UK-India and Centre-State collaboration opportunities and mechanisms to tackle the challenges that emerge from the findings of workstream 1 and 2 and builds recommendations for both policy and structural issues in the GST regime.

## 2. Methodology

This chapter outlines the methodology adopted towards (i) selection of states, (ii) estimating the impact of withdrawal of GST compensation on selected state revenues post June 2022 and (iii) its consequent impact on development spending of selected states.

### 2.1. Selection of states

For the study, the three states selected are Haryana, Karnataka, and Tamil Nadu. The selection of states allows for an inclusive geo-political spread across the country. These states also have a high footprint of British businesses and British Deputy High Commission offices. This section describes how the three states fare on aspects like the (ex-ante) ability to collect taxes, actual collection performance in 2019-20 and implications of a tax shortfall.

The three states differ on the share of industrial GVA in total Gross State Value Added (GSVA) in the pre-GST period. In the pre-GST period, i.e., 2014-15 to 2016-17, the average share of industrial GSVA for Haryana (31.8%) is close to the all-state average (31%), Karnataka's share is lower (24%), and that of Tamil Nadu's is higher at 34%. This is important as GST is a destination-based tax and at the time of GST implementation, it was believed that the manufacturing/production heavy states would lose out on tax revenues relative to consumption-based states.

The three states – Haryana, Karnataka and Tamil Nadu are ranked third, sixth and tenth in terms of SGST collected, as proportion of GSDP for 2019-20. The relative ranking is also similar in the previous year, 2018-19. All three states register a better SGST to GSDP ratio than all states' median value. Haryana is one of the top three performers in both the years. Haryana's top performance allows for setting a benchmark to compare the performance of the other two states.

Revenue shortfalls, with the discontinuation of GST compensation, could translate into low development expenditure. This may have implications on the achievement of Sustainable Development Goals (SDG). Given the progress made so far on the SDGs, the current decade is a "Decade of action". As per SDG Index 2021, India's rank is 120 out of 165 countries. In 2015, all UN member states agreed to achieve 17 SDGs by 2030. It is well recognized that while the SDG goals and targets are relatively global/national, the achievement of these targets are dependent on progress at the state and the local government level. With this perspective in mind, Government of India has rightly acknowledged in the Voluntary National Review (VNR) 2020 and interprets localizing SDGs as "process of understanding, adapting, planning, implementing, and monitoring the SDGs from national to local levels by relevant institutions<sup>4</sup>." States have the power and functions to set up and execute policies in relation to almost all SDGs and their associated targets.

Notably, the development expenditure undertaken by all three states, as proportion of GSDP, as well as in per capita terms are below the all-state average. However, their performance on development indicators varies. For instance - the percentage of population living below the national poverty line is 11.16% for Haryana and 11.28% for Tamil Nadu, while the value for Karnataka is 20.91%<sup>5</sup>. Haryana performs worse than both states in Maternal Mortality Rate but has a much higher percentage of fully immunized children in the 0 to 5 years age group<sup>6</sup>. Sex ratio at birth is the lowest for Haryana and highest for Karnataka out of the three states<sup>7</sup>. In the subsequent section, we discuss the methodology to estimate revenue shortfall post discontinuation of compensation to states in June 2022.

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<sup>4</sup> Decade of Action: Taking SDGs from Global to Local - India VNR 2020 available at [https://sustainabledevelopment.un.org/content/documents/26281VNR\\_2020\\_India\\_Report.pdf](https://sustainabledevelopment.un.org/content/documents/26281VNR_2020_India_Report.pdf)

<sup>5</sup> As reported in Niti Aayog's SDG India Index 2019-20. These estimates are as per the Tendulkar Committee estimates in 2011-12

<sup>6</sup> As reported in Niti Aayog's SDG India Index 2019-20. These estimates are based on Ministry of Home Affairs [Special Bulletin - Sample Registration System] for the year 2015-17 and 75th Round of the National Sample Survey for the year 2017-18.

<sup>7</sup> As reported in Niti Aayog's SDG India Index 2019-20. These estimates are based on Ministry of Home Affairs [Special Bulletin - Sample Registration System] for the year 2015-17.

## 2.2. Estimation of revenue shortfall

The literature on estimating tax potential employs a variety of methodologies, often depending on the agency carrying out the analysis and the availability of data. Broadly, the methodologies can be divided into two categories – the bottom-up approach and the top-down approach. Most official estimates (e.g., the tax authorities in UK and the USA for income tax) employ the bottom-up approach as they have at their disposal complete taxpayer information at a fully disaggregated level. This methodology is generally ruled out for non-official agencies.

Another type of bottom-up methodology involves using available information of detailed tax base (say, consumption), estimate tax potential using applicable tax rate(s), and comparing such estimates with actual tax collection to estimate the tax gap. This methodology also involves a large amount of disaggregated information; unfortunately, data on the only possible detailed tax base for GST – consumption, is quite dated in India, i.e., 2011-12.

The top-down approach is based on a single estimate of the tax base from which a theoretical tax liability may be calculated. Theoretical liability is the tax that would be collected assuming 100 percent compliance by all parties. The tax gap, then, will be the difference between theoretical liability and total tax collected. A variation of the broad top-down approach can be used here. To determine the compensation to states in India on account of revenue loss entailed by introduction of GST, for example, a method of applying a fixed growth rate (14%) on the base year collections from all the taxes subsumed under GST can be utilized to estimate potential revenue or the revenue under protection.

The amount by which such potential revenue exceeded the actual GST collection was the compensation due. This method was part of the statutory framework for GST, applicable till June 2022. Therefore, the Revenue Under Protection (RUP) formula is used to estimate the potential revenue (i.e., theoretical liability) from GST for the states for the ensuing 3-5 years. To estimate the potential shortfall, the revenue collections need to be projected; this was done based on buoyancy of past collections. Tax Buoyancy is defined as the percentage change in tax collections with one percentage change in tax base, i.e., Gross Domestic Product. GST was launched in July 2017; therefore, data is available for the period post July 2017 only. At State level, tax base data, i.e., GSDP is available only at annual frequency. Due to limited data points to estimate GST buoyancy at state level, national level GST buoyancy using quarterly GDP and GST statistics is estimated. Three scenarios were constructed: minimum buoyancy (1.28), average buoyancy (1.69) and maximum buoyancy (1.95), experienced during the GST period at the all-India level. GST collections at national level are forecasted under different buoyancies and projected GDP growth. Using average share of states in all-India GST collections in the past, the GST collections were forecasted for the three selected states for the period 2022-23 to 2026-27.

*Revenue Under Protection (RUP) is considered to be potential revenue and shortfall is estimated as the gap between projected GST collections based buoyancy and RUP.*

It may be noted that as buoyancy improves, the projected revenue of states would be progressively higher. This would subsequently lead to lower revenue shortfalls. A sufficiently high buoyancy may even eliminate revenue shortfall. Further, the speed of this process would also be determined by the level of buoyancy. The estimates provide some empirical evidence for this a priori observation to indicate the extent of increase in buoyancy needed to limit the GST revenue shortfall in the three selected states. The intent is to provide some idea of the difficulty the three states would face to manage the loss of revenue after June 2022.

However, due care is needed while doing so because of the following:

**Fact 1:** GST was introduced in India on 1st of July 2017. Since then, real GDP growth shows a secular decline. It was 6.8% in 2017-18, followed by 6.5% in 2018-19 (3<sup>rd</sup> Revised Estimates) before reaching 3.7% (2<sup>nd</sup> Revised Estimates) in 2019-20. Then due to COVID-19, the economy went into a tailspin and contracted by 6.6% (1<sup>st</sup> Revised Estimates). Such volatility needs to be taken into consideration while projecting actual GST collection.

**Fact 2:** Volatility in GST collection vis-à-vis the target is much more pronounced.

Every year actual GST collection remained lower than the budget estimate. In 2018-19, the amount of shortfall was INR 1.6 trillion which was less than 21.8% of the budgeted amount. In the next year, the shortfall vis-à-vis Budget Estimates (BE) was 9.7% and in 2020-21, GST revenue had fallen by 25.4% vis-à-vis the BE target as per the Budget statement. However, subsequent press releases suggest that the discrepancy is around 20% from the budgeted amount. The same story goes for collection of GST compensation cess. In 2021-22 only, government expects to collect 7% more than budgeted. **Therefore, GST collection is yet to stabilize and due to numerous challenges, collections always remained below the target.**

The step-by-step methodology adopted to estimate the revenue shortfall for the select states has been illustrated in Figure 1.

**Figure 1: Methodology followed for revenue shortfall estimation post June 2022**



**Key Assumptions:**

- Not being linked with the current state of the economy in any way, the above-mentioned method of estimating potential revenue or revenue under protection ran into problems with an economic slowdown followed by the pandemic-induced recession. The financing mechanism for the compensation scheme (GST-linked cess on selected commodities) failed to fully cover the needed amount; and stop-gap mechanisms for borrowing had to be introduced to prevent shocks to the state finances. Despite the shortcoming, once built into the statute, the method of estimating potential revenue as described above has become the accepted benchmark which is a key assumption. It, therefore, seems appropriate to compute potential revenue shortfall based on the same statutory method and project actual collections, once the compensation cess ceases to exist, based on past trend/buoyancy to arrive at the potential gap.
- Total GST collection at State level has been calculated as the sum of SGST and IGST settlement. Here, SGST is the revenue collected for intra-state trade, as part of State government’s share of taxes under GST regime while IGST settlement is the amount that is transferred to States/UTs considering adjustments due to inter-state transactions. For calculating GST collection at the state level, only regular IGST settlement has been considered as available on the Goods and Services Tax Network (GSTN)<sup>8</sup> portal. There may also be ad-hoc or provisional settlements which have not been considered. Further, it is important to note that in the analyses, GST collection at the state level excludes GST Compensation Cess and IGST on imports.
- Regarding GDP data, for the year 2018-19, third revised estimates for annual series (used to forecast GST based on buoyancy scenarios) are available with MOSPI, but not for quarterly GDP data. Hence, second revised estimates for 2018-19 annual series and quarterly data have been used.

**2.3. Development spending impact estimation**

With expected impact on revenues, it is possible that states will have to cut down on their expenditure plans to ensure a reasonable fiscal deficit. This part of the analysis focuses on assessing the impact on development expenditure as state revenues underperform post the end of the compensation period.

A panel data analysis of **25 states** was conducted to assess the impact of GST collection on development expenditure, controlling for various state level variables. Given that revenues are fungible, and a reduction in revenue through any source would have a similar impact, we have used state revenue receipts as the primary explanatory variable of interest. This allows us to use longer time series of data, making the estimation more robust.

<sup>8</sup> GSTN is a non-profit, non-government organisation which manages the entire IT system of the GST portal.

The dependent variable of interest is **the share of development expenditure in total expenditure**. The numerator refers to the sum of expenditures incurred by the state on economic and social services such as crop husbandry, rural development, transport and communication, education, health, etc. It includes development spending in the form of revenue expenditure, capital outlay and loans and advances given by the State Government. The denominator is the sum of development and non-development expenditure<sup>9</sup>. The independent variables are defined in Table 1.

**Table 1: Independent variables used in the regression**

Variable	Variable transformation	Data source	Expected relationship with dependent variable
Revenue receipts	Natural log of a state's revenue receipts in the specification	Reserve Bank of India's Study of State Budget	This is our primary variable of interest. We hypothesize that this has a positive relationship with the dependent variable.
Per capita income	Natural log of a state's per-capita income in the specification	Ministry of Statistics and Programme Implementation (MoSPI)	We expect a negative relationship which may indicate that poorer states – with greater needs – have relatively higher spending on development.
Fiscal deficit	Fiscal deficit as percentage of Gross State Domestic Product (GSDP)	Reserve Bank of India's Study of State Budget, MoSPI	A priori, this may be positive or negative. There is improvement in fiscal parameters overtime especially in pre-covid period. States have tried to keep fiscal deficit below 3 percent apart from few exceptions. A positive sign indicates states are using available resource envelope including borrowings up to 3 percent of GSDP in a year for development spending.
Infra index	<p>A composite index was created based on the following indicators:</p> <ul style="list-style-type: none"> <li>National highway length (in km)</li> <li>Road length in state (in km)</li> <li>Railway routes (in km)</li> <li>Power availability (in net core units)</li> </ul> <p>Each of these indicators were normalized using the min – max formula and aggregated using a simple average.<sup>10</sup></p>	Reserve Bank of India's Handbook on Indian Economy, Central Electricity Authority, Ministry of Power, Government of India	A negative sign may indicate that less infrastructurally developed states have a higher share of development expenditure in total expenditure reflecting development needs.
Education index	<p>A composite index was created based on the following indicators:</p> <ul style="list-style-type: none"> <li>Reading level results for</li> </ul>	ASER Centre	A negative sign may indicate that states with relatively lower learning outcomes have a high share of development expenditure in total

<sup>9</sup> Non-developmental expenditures includes expenditures on interest payments, pensions, administrative services, etc.

<sup>10</sup> Max-min formula states that:

$$\text{Normalized value of } X = \frac{X - X_{\min}}{X_{\max} - X_{\min}}$$

As a result, the normalized value ranges between 0 and 1 with a higher score indicating better performance.

Variable	Variable transformation	Data source	Expected relationship with dependent variable
	<p>enrolled children – percentage of students able to read Standard II paragraph.</p> <ul style="list-style-type: none"> <li>Arithmetic Level Results for Enrolled Children – percentage of students able to perform division.</li> </ul> <p>Each of these indicators were normalized using the min – max formula and aggregated using a simple average.</p>		expenditure, reflecting development needs.

Based on the panel regression results, development expenditure as a share of total expenditure is forecasted under two scenarios:

- i. Revenue under protection (based on 14% growth rate)
- ii. Revenue based projected GST collection (from quantitative analysis)

The difference between the estimated development expenditure provides the gap in development expenditure.

## 2.4. Stakeholder Consultations

For gaining a micro-level understanding of the challenges and benefits of the GST regime, both taxpayers as well as tax administration authorities were consulted. To obtain the taxpayers perspective, consultations were conducted with private sector companies, including UK companies to understand challenges faced across GST flowchart, i.e., GST registration, assessment, payment, refund, audit, appeals, etc. For this study, the consultations focussed on sectors such as Financial Services, E-commerce, Advanced Engineering. To gain a holistic view of the challenges faced in agriculture, automobiles, and healthcare, stakeholder consultations were also conducted with some industry associations. Moreover, to understand challenges faced by smaller organizations due to the introduction of GST regime, MSME Associations from Haryana and Tamil Nadu were also consulted.

To obtain the tax administration perspective, Additional Commissioner of GST Haryana was consulted to elicit views on challenges faced and scope of improvement on the overall GST compliance processes. The discussions also revolved around the capacity development requirements for GST officers in the State that will help drive overall tax administration efficiency.

Thus, the stakeholder consultations shed light on the lacunae in the tax administration and ways to ease business compliance. Thus, apart from literature review, stakeholder consultations help identify potential UK-India and centre-state collaboration opportunities and mechanisms. In the next chapter, we discuss the GST flowchart, key challenges in GST administration and cost and timelines.

# 3. Workstream-1: GST Flowchart

## 3.1. India's transition to the GST regime

The GST journey began in the year 2000 when a Committee was set up to draft the law. Initially, it was proposed that GST would be introduced from 1<sup>st</sup> April 2010. However, due to the difference of opinions amongst the stakeholders, the implementation was delayed. Finally, after carrying out certain Constitutional amendments, the GST Bill was passed, and GST was launched on 1<sup>st</sup> July 2017.

Under the erstwhile indirect tax regime, the Constitution of India empowered the Central Government to levy Excise duty and Service tax, while Value Added Tax (VAT) and Central Sales Tax came under the purview of the State Governments. The nature of roles of state government officials was restricted to VAT or Sales tax. On the other hand, central level officials largely dealt with excise duty and service tax. Further, many States levied other additional taxes such as an Entry tax on the entry of goods in the respective state.

This multiplicity of taxes at the State and Central levels resulted in a complex indirect tax structure in the country which had hidden costs for the trade and industry. The introduction of GST thus marked a clear departure from the scheme of distribution of fiscal powers envisaged in the Constitution. GST ushered in a common tax structure, common tax base and uniform GST laws across India, with a single IT interface through the Goods and Services Tax Network (GSTN) portal. This reduced the cascading effect of taxes, ensured transparency and accountability in the tax administration.

The dual GST envisaged taxation of the same taxable event, i.e., supply of goods and services, simultaneously by both the Centre and the States across the value chain from the stage of manufacture to consumption. The Centre levies and collects Central Goods and Services Tax (CGST) and States levy and collect the State Goods and Services Tax (SGST) on all transactions within a State. The Input Tax Credit (ITC) of CGST is available for discharging the CGST liability on the output at each stage. Similarly, the credit of SGST paid on inputs is allowed for paying the SGST on output. However, no cross utilization of credit is permitted between CGST and SGST.

As far as inter-state supplies are concerned, India adopted a unique model of Integrated Goods and Services Tax (IGST), which is equal to the sum of applicable CGST and SGST. It is a mechanism to ensure that the SGST component accrues to the State of final consumption/ destination, even though the IGST is paid in the originating state. Moreover, it maintains the integrity of the ITC chain in inter-state transactions. IGST is also levied on cross-border supplies into India as such transactions are considered as inter-state supplies.

### Rate Structure

The GST rate slabs are recommended by the GST Council. The GST Council was setup under Article 279A (1) of the Constitution of India. The Council is a joint forum of the Centre and the States and consists of the following members: a) Union Finance Minister - Chairperson b) The Union Minister of State, in-charge of Revenue of finance - Member c) The Minister In-charge of finance or taxation or any other Minister nominated by each State Government – Members. The Council is mandated to make recommendations to the Union and the States on important issues related to GST, such as the goods and services that may be subjected or exempted from GST, model GST Laws, principles that govern place of supply, threshold limits, GST rates including the floor rates with bands, special rates for raising additional resources during natural calamities/disasters, special provisions for certain States, etc.<sup>11</sup>

The GST rates are usually high for luxury supplies and low for essential items of mass consumption. In India, the GST rate for various goods and services is divided into different slabs such as 5%, 12%, 18% and 28%. In addition, there are other prescribed rates on certain goods such as 3% on gold/ silver/ precious stones, etc. Furthermore, a GST Compensation Cess is also levied on specified goods/ services.

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<sup>11</sup> <https://gstcouncil.gov.in/gst-council>

## Types of levies in GST

Under the GST law<sup>12</sup>, the following types of GST are levied:

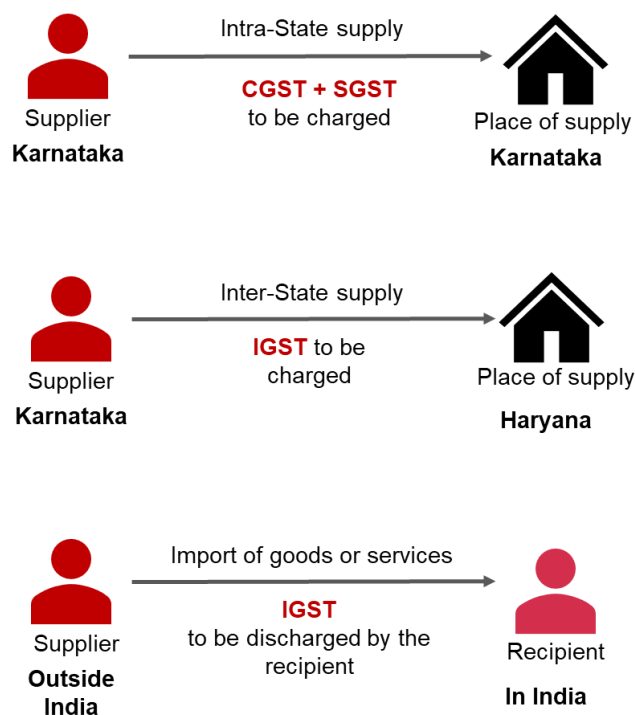
- **CGST** – This applies to the intra-state (within the state) supply of goods and services and is levied by the Central Government. The CGST Act governs this type of GST. The tax collected under the head 'CGST' is payable to the Central Government treasury.
- **IGST** – This applies to the inter-state supply of goods and services and on the goods and services that are imported as well as exported. The IGST Act governs this type of GST, and the Central Government is responsible for the collection of IGST.

The collected IGST is equally divided into central and state government portions. The State portion of the IGST is provided to the state where the goods and services are received and the remaining IGST received goes to the central government.

- **SGST**- This applies to the intra-state (within the state) supply of goods and services and is levied by the State Government. The revenue earned through SGST is solely claimed by the respective State government.
- **UTGST**- The Union Territory Goods and Services Tax is a type of GST imposed on the goods and services in the Union Territories. This is similar to SGST but applies only to the Union Territories.

Additionally, **GST Compensation Cess** is also levied on the supply of specified goods or services to provide compensation to States till June 2022 for loss of revenue arising due to implementation of GST. The GST Council has permitted the continuance of this levy till March 2026.

**Figure 2 Levy of GST Scenarios**



<sup>12</sup> "GST Law" has been used as an overarching term for all the GST Acts, Rules, notifications, circulars, instructions, etc. issued by the Government.

### Box 1: GST Compensation Cess and Government of India's borrowing to finance compensation fund

A GST Compensation Cess is also levied on supply of specified goods or services to provide compensation to States till June 2022 for loss of revenue arising due to implementation of GST. Proceeds of GST compensation cess are credited to a non-lapsable fund known as the GST Compensation Fund managed by the Centre.

GST compensation for FY 2017-18, 2018-19 and 2019-20 was paid to the States out of the GST Compensation Fund. During FY 2020-21 and FY 2021-22, the negative impact of the pandemic on businesses operations resulted in lower GST collections, thus warranting higher compensation. Thus, the Centre decided to borrow the required amount from the market. In FY 2020-21, the Centre had borrowed Rs. 1.1 lakh crore (11,021 GBP Mn) under a special window and passed it on to the States. For FY 2021-22 the Centre borrowed Rs. 1.59 lakh crore (15,900 GBP Mn) from the market through a special window and passed it on to States/UTs in tranches. The borrowed amount was provided to States and UTs as a back-to-back loan. However, neither principal nor interest will be paid by States. To help the Centre repay this additional borrowing along with interest, the GST Council has permitted the continuance of this levy till March 2026. However, the payment of compensation to the States is set to cease from June 2022.

GST compensation cess released		(1 GBP = INR 100)			
Particulars	2017-18	2018-19	2019-20	2020-21	2021-22
Compensation cess released from GST Compensation Fund	INR 49,276 Crore (4,927.6 GBP Mn)	INR 81,887 Crore (8,188.7 GBP Mn)	INR 1.6 lakh crore (16,530.2 GBP Mn)	INR 91,000 Crore (9,100 GBP Mn)	INR 60,000 crore (6,000 GBP Mn)
Compensation through back-to-back loan through special window	-	-	-	INR 1.1 lakh crore (11,021.80 GBP Mn)	INR 1.59 lakh crore (15,900 GBM Mn)
<b>Total</b>	<b>INR 49,276 Crore (4,927.6 GBP Mn)</b>	<b>INR 81,887 Crore (8,188.7 GBP Mn)</b>	<b>INR 1.6 lakh crore (16,530.2 GBP Mn)</b>	<b>INR 2 lakh Crore (20,120.8 GBP Mn)</b>	<b>INR 2.19 lakh Crore (21,900 GBP Mn)</b>

Source: <https://m.rbi.org.in/Scripts/PublicationsView.aspx?id=20833>, Press Information Bureau, <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1736891>

### Input tax credit utilization

Typically, GST is an indirect tax which should be a tax passed on to the ultimate consumer, with businesses not having to bear it themselves. An uninterrupted and seamless ITC chain would ensure elimination of cascading effect of taxes in the value chain. However, in India, the GST law has placed several restrictive conditions to avail ITC resulting in businesses facing cash-flow issues and a higher cost burden.

The mechanics for input tax credit utilization under the GST law is as under:

- **Input tax credit on account of IGST** – This shall first be utilised towards payment of IGST and the amount remaining, if any, shall be utilised towards the payment of CGST and SGST or UTGST in any order.
- **Input tax credit on account of CGST, SGST or UTGST** – This shall be utilised towards payment of IGST, CGST, SGST or UTGST, as the case may be, only after the input tax credit available on account of IGST has first been completely exhausted.
- **Input tax credit on account of Cess** – This shall be utilized only towards payment of Cess liability.

The above setoff mechanism is depicted in Figure 3.

**Figure 3: Provision to claim Input Tax Credit**

		Output Tax Liability			
		IGST	CGST	SGST	CESS
Input Tax Credit	IGST	1	2	2	X
	CGST	2	1	X	X
	SGST	2	X	1	X
	CESS	X	X	X	1

1: First claim; 2: Second claim; X: Not allowed

Source - Rule 49, 49A, 49B and 88A of CGST Rules, 2017

### 3.2. How India's GST regime differs from other regions

GST is not a new concept in the world economy. It has been in existence since the 1950s. It was first brought into effect as VAT by the Government of France, after which many other countries adopted it in some form or the other. Today, it is prevalent in more than 160 nations including the European Union and Asian countries. Approximately, about 90% of the world's population live in countries with VAT or GST as the indirect tax system.

A key differentiation in the way GST has been adopted in India and elsewhere, is that India follows a dual GST levy system in line with the Constitutional powers bestowed on the Union and on the States. Brazil and Canada too have multiple VAT/ GST levies at the Federal/ Provincial levels. In many other countries like Australia however, GST is levied at the federal level on behalf of the States with the GST revenue being distributed to the States.

In India, GST registration is mandatory in each State of operation, which has resulted in multiple return filings and higher compliance burden for businesses that have pan India presence. There is also some overlap in the tax administration, as investigation for tax evasion can be done either by the Central or the State tax administrations, whichever strikes first. **A few countries like Australia allow large businesses to take a Group GST registration. Such a facility if introduced in India will help businesses having PAN India entities. Such entities could be permitted under law to submit a common GST return, resulting in lower compliance costs and improved cash-flows.**

In the Indian GST setup, there are multiple tax slabs (such as 5%, 12%, 18%, 28%) in which goods/ services have been placed. The rate of 28% is amongst the highest rates globally. Further, a Compensation Cess is also levied on some goods or services to provide compensation to the states for loss of revenue due to implementation of GST. India has adopted a multiple rate structure to ensure that the tax rate on essential commodities of mass consumption remain lower than the rate on other items. **In countries like Australia, the supply of goods or services are taxable at a standard rate of 10% since the introduction of GST in 2000. Similarly, VAT was introduced in Korea in 1977 at a standard rate of 10% and has remained at this rate till date. A Group of Ministers constituted by the GST Council is currently focusing on strategies to rationalize and simplify the existing tax structure.**

Another key differentiator is that the Indian taxation system has stringent rules specifically with respect to availing ITC and filing of returns. In India, ITC is available only when the supplier has filed its GST return and made the GST payment to the government. **Where the supplier delays or files an incorrect return, it hinders the flow of the input credit and leads to blocking of funds in the hands of recipient. Thus, organizations require**

**more working capital resulting in increased costs of doing business. However, in other countries like Australia and Republic of Korea, ITC is available basis the copy of the valid tax invoice available with the recipient.**

As regards returns, India requires multiple returns to be filed by every taxpayer on a monthly/ quarterly basis in addition to filing of annual returns. However, in many other countries like Canada, Australia, and Republic of Korea, only a single periodic return is to be filed by the taxpayers, thus easing out the compliance burden in the hands of the taxpayer.

Table 2 compares the Indian GST law with the law of Canada, UK Brazil, Republic of Korea, and Australia on some broad parameters:

**Table 2: Comparison of Indian GST law with Canada, Brazil, Republic of Korea, and Australia**

Parameter	India	United Kingdom	Canada	Brazil	Republic of Korea	Australia
<b>Threshold for registration</b>	Supply of goods > INR 40 lakhs (≈ GBP 0.04 Mn)  Supply of service > INR 20 lakhs (≈ GBP 0.02 Mn)	Turnover of goods or services ≥ GBP 0.085 Mn	Turnover of goods or services > CAD 30000 in the last 4 calendar quarters (≈ GBP 0.02 Mn)	No threshold	No threshold	Turnover of goods or services ≥ 75000 AUD (≈ GBP 0.04 Mn)
<b>Tax Structure</b>	Dual levy structure (Blend of Central and State GST)	Value added tax	Blend of Federal GST & Harmonized Sales Tax	State value-added tax (ICMS) Federal value-added tax (IPI) Municipal service tax (ISS)	Value added tax (National tax)	Goods and Services tax (Federal tax)
<b>Tax rate structure</b>	0%, 0.25%, 3%, 5%, 12%, 18%, 28%  Compensation Cess – 160% (Chewing tobacco), 12% (Aerated water) etc.	Standard rate-20%  Other-Zero rated (0%) and reduced rate (5%)	Standard GST 5% and HST varies from 0% to 15%	ICMS (Intra-state)- 0% to 35%  ICMS (Inter-state) - 4%, 7% or 12%  IPI 0% to 300%	Standard rate-10%  Other-Zero rated (0%) an exempt	Standard rate-10%  Other-Zero rated (0%) and exempt
<b>GST compliances</b>	Turnover > INR 5 crores - Monthly GST returns (≈ GBP 0.50 Mn)  Turnover < INR 5 crores - Quarterly GST returns (≈ GBP 0.50 Mn)	Quarterly return  Monthly return-If requested by a business that receives regular repayments  Annual return-If requested by a small business (annual turnover less than GBP1.35 million excluding VAT)	Turnover > CAD 6 Mn (≈ GBP 3.61 Mn) – Monthly returns  Turnover > CAD1.5 Mn (≈ GBP 0.90 Mn) < CAD 6 Mn (≈ GBP 3.61 Mn) – Quarterly returns	Monthly return  Annual Return in specified cases	Quarterly Return	Turnover > AUD 20 Mn-Monthly (≈ GBP 11.01 Mn)  Turnover < AUD 20 Mn (≈ GBP 11.01 Mn) - Quarterly  Turnover < AUD 75000-Annually (≈ GBP 0.04 Mn)

+

Parameter	India	United Kingdom	Canada	Brazil	Republic of Korea	Australia
	Annual returns		Turnover < CAD 1.5 Mn (≈ GBP 0.90 Mn) – Annually			
<b>Electronic Invoicing</b>	Mandatory for B2B if turnover exceeds INR 20 crores (≈ GBP 2 Mn)	NA	Allowed but not mandatory	Mandatory without threshold	Mandatory, if turnover exceeds KRW300 million (≈ GBP 0.19 Mn)	Presently, it is limited to exchange of information between supplier and buyer and not for GST compliance activities
<b>ITC matching concept</b>	Yes	No matching concept. However, ITC available basis invoice of supplier	No matching concept. However, ITC available basis invoice/ E-invoice of supplier	ITC available basis electronic invoice	No matching concept. However, ITC available basis invoice of supplier	No matching concept. However, ITC available basis invoice of supplier
<b>Reverse charge mechanism (i.e., liability to pay tax on the recipient)</b>	Yes, in specified cases like import of services/ domestic supplies such as services by GTA, advocate, sponsorship services	Yes, in specified cases like if a non-established business supplies services to a UK taxable person, telecommunication services etc.	Yes, in specified cases like importation of intangible personal property & services acquired from unregistered nonregistered persons outside Canada	Yes, in specified cases like importation of goods/ services  No domestic reverse charge	Yes, in specified cases like receipt of services and intangible properties from a non-resident or foreign corporation  Domestic reverse charge in specified cases	Yes, in specified cases like importation of goods/ services  Domestic reverse charge in specified cases like procurement of valuable metals by registered entity
<b>Group Registration</b>	Not allowed	Allowed in certain cases which is organizations under common control	Not allowed	Not allowed	Not allowed	Two or more closely related entities may form a GST group

Parameter	India	United Kingdom	Canada	Brazil	Republic of Korea	Australia
<b>Refund</b>	Allowed in specified cases (exports, supply to SEZ etc.)	Allowed in specified cases like where ITC exceeds outward tax liability on account of zero-rated supplies or otherwise  This is done automatically by submitting the periodic VAT return	Allowed in specified cases like where ITC exceeds outward tax liability on account of zero-rated supplies or otherwise	Refund generally not allowed. Where ITC exceeds outward tax payable, excess is used to offset tax payments for subsequent months or transferred to third party in certain cases	Allowed in specified cases like where ITC exceeds outward tax liability on account of zero-rated supplies or otherwise  Early refund within 15 days in specified cases like where taxpayer makes zero rated supplies	Allowed in specified cases like where ITC exceeds outward tax liability on account of zero-rated supplies or otherwise
<b>Dispute Resolution</b>	<p>1. Option to obtain the clarification on complex transactions in advance by filing an application of Advance Ruling-</p> <p>2. Option to file an appeal against the order of adjudicating authority. <b>Level of Appeals are -</b></p> <p>a. First appellate authority</p>	<p>1. Option to obtain the clarification on the query raised about a tax decision- <b>HMRC</b></p> <p>2. Option to file an appeal against the decision of HMRC. <b>Level of appeals are-</b></p> <p>a. Tax tribunal (First tier tribunal) b. Upper Tier Tribunal c. Court of appeal d. Supreme court</p>	<p>1. Reprisal complaint against the decision of CRA</p> <p>2. Option to file an objection against the notice of assessment</p> <p>3. If taxpayer disagrees with the CRA's decision on objection, an appeal can be filed in tax court of Canada</p> <p>Further levels of appeals are -</p>	Refer Note	<p>Objection or appeal system is divided into the <b>advance remedy system and ex-facto remedy system.</b></p> <p>1. Review for adequacy of tax imposition as an <b>advance remedy-taxpayer</b> who receives a pre-assessment notice may request a review of the adequacy of such result by the relevant tax office head</p>	<p>1. Option to lodge objection to an <b>ATO decision</b></p> <p>2. Option to seek External Review against the decision of objection raised.</p> <p>a. Administrative Appeal Tribunal b. Federal Court of Australia c. Full court of Federal Court of Australia d. High Court</p> <p>3. Other options for resolving disputes are -</p> <p>a. <u>Alternative Dispute Resolution</u>- an impartial person helps those in a</p>

Parameter	India	United Kingdom	Canada	Brazil	Republic of Korea	Australia
	<p>b. Appellate Tribunal</p> <p>c. High Court</p> <p>d. Supreme Court</p>		<p>a. Federal Court of Appeal</p> <p>b. Supreme Court</p>		<p><b>2. Ex-facto remedy</b> system is a two-tiered system involving administrative relief (administrative appeal) and judicial relief (administrative litigation).</p> <p><b><u>Administrative Appeal</u></b></p> <p>a. Administrative Appeal-Head of a regional or district tax office</p> <p>b. National Tax Service or tax tribunal</p> <p><b><u>Administrative Litigation</u></b></p> <ul style="list-style-type: none"> <li>• Administrative Courts/District Courts</li> <li>• High Court</li> <li>• Supreme Court</li> </ul>	<p>dispute to resolve or narrow the issues between them.</p> <p>b. <b><u>In-house facilitation</u></b>- A mediation process where an impartial ATO facilitator meets with taxpayer (i.e., individuals and small taxpayers) and the ATO case officers to resolve dispute.</p> <p>c. <b><u>Test-case litigation programme</u></b> - provides financial assistance to taxpayers to help them meet some, or all, of the reasonable litigation costs for ATO-law related cases.</p> <p>d. <b><u>Panel discussion on dispute resolution</u></b> - Panel of experts share their insights into dealing with tax disputes and answer questions on dispute resolution.</p> <p><b><u>Dispute Assist-Free</u></b> service to help individuals and small businesses with the dispute process.</p>

Parameter	India	United Kingdom	Canada	Brazil	Republic of Korea	Australia
Source	<a href="https://www.cbic.gov.in">https://www.cbic.gov.in</a>	<a href="https://www.legislation.gov.uk/ukpga/1994/23/contents">https://www.legislation.gov.uk/ukpga/1994/23/contents</a>	<a href="https://www.canada.ca">https://www.canada.ca</a>	<a href="https://taxsummaries.pwc.com/brazil/corporate/other-taxes">https://taxsummaries.pwc.com/brazil/corporate/other-taxes</a>	<a href="https://elaw.klri.re.kr">https://elaw.klri.re.kr</a>	<a href="https://www.legislation.gov.au/">https://www.legislation.gov.au/</a>

*Note: The information regarding tax dispute resolution mechanism in Brazil is not readily available on the public domain in English language and hence, we are not able to comment on the same.*

### 3.3. GST Compliance journey

Prior to the introduction of GST, the indirect taxation regime was a complex web of Central and State legislations, with multiple tax administrations and disparate regulatory and compliance frameworks, some digitally enabled and others not. There was also the added problem of cascading effect of these taxes.

**With the launch of the GST system, these multiple indirect taxation structures were replaced by a uniform set of rules and regulations and a single IT-interface under GSTN for all the taxpayers, irrespective of where taxpayers are located. This has greatly enhanced ease of doing business and has reduced the compliance burden on taxpayers. The ITC mechanism in GST has vastly eliminated the cascading effect which earlier impacted the taxpayers as well as consumers. At the same time, the GST law prescribes strict provisions to ensure compliance and enforcement across various areas such as GST registration, return-filing, refunds, and assessments.**

Typically, the compliance journey for any taxpayer involves the following steps:



#### 1. GST Registration

Under any law, registration is the most fundamental requirement for the identification of taxpayers ensuring tax compliance in the economy. GST being a tax on the event of “supply”, every supplier needs to get registered in each State or Union territory from where the supply is made if its all-India turnover exceeds the threshold limit. However, small businesses having an all-India aggregate turnover below the threshold limit are not required to register. However, such businesses may voluntarily opt to register. Details of state wise threshold are given in Table 3.

**Table 3: State wise threshold for GST registration**

For sale of goods	Threshold
Puducherry, Meghalaya, Mizoram, Tripura, Manipur, Sikkim, Nagaland, Arunachal Pradesh, Uttarakhand, and Telangana	INR 20 Lakhs (≈ GBP 0.02 Mn)
For other states	INR 40 Lakhs (≈ GBP 0.04 Mn)
For sale of services	
For normal category states	INR 20 Lakhs (≈ GBP 0.02 Mn)
For special category states (Assam, Jammu and Kashmir, Meghalaya, Arunachal Pradesh, Manipur, Sikkim, Tripura, Mizoram, Nagaland, Himachal Pradesh, Uttarakhand)	INR 10 Lakhs (≈ GBP 0.01 Mn)

Source - Section 22 of CGST Act, 2017

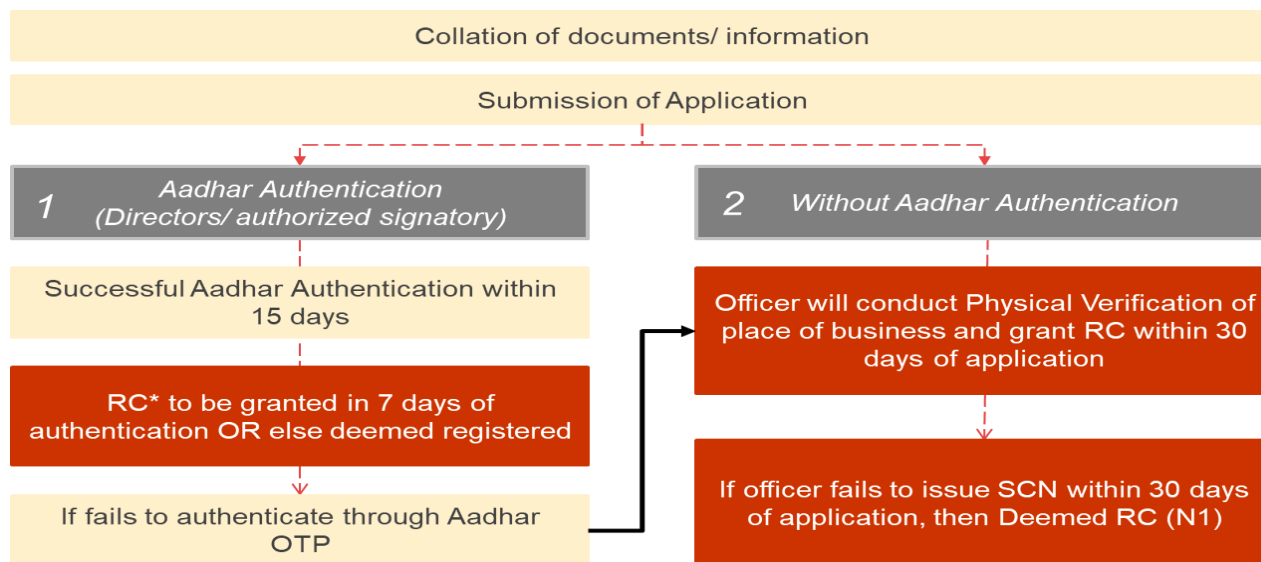
Additionally, the GST law enlists certain categories of suppliers who are required to get compulsory registration irrespective of their turnover. Some of such suppliers include:

- Inter-state suppliers except persons making inter-state supplies of taxable services and having an aggregate turnover below threshold limit;
- A person receiving supplies on which tax is payable by recipient on reverse charge basis;
- Casual taxable person not having fixed place of business in the State or Union Territory from where he wants to make supply;
- Non-resident taxable persons not having fixed place of business in India;
- A person who supplies on behalf of some other taxable person (i.e., an Agent of some Principal);
- E-commerce operators (who are liable to collect tax at source), who provide a platform to the suppliers to supply goods and services through it;

- TDS Deductor;
- Input service distributor;
- Those supplying online information and database access or retrieval services from outside India to a non-registered person in India.

Registration under GST involves obtaining a unique number from the tax authorities. For obtaining registration, an online application is to be filed on the GSTN by the person along with prescribed documents within thirty days from the date when liability to register arises. The general process of registration is provided in Figure 4.

**Figure 4: General process of GST Registration**



Source - Rule 8 and Rule 9 of CGST Rules, 2017

Note-Aadhaar is a 12-digit individual identification number issued by the Unique Identification Authority of India on behalf of the Government of India.

Further, separate procedures have been prescribed for other registrations like non-resident taxable person, tax deductor, tax collector and OIDAR service provider.

### Challenges with GST Registration

1. **New Registrations** – Generally, the process of obtaining registration is quite simple. However, in few cases, the taxpayers face challenges because the authorities demand documentation/ information which is not prescribed under the law even though valid KYC/ Registration documents are already submitted by the person seeking registration. This creates unnecessary hurdles in obtaining registration and makes the entire procedure complex and cumbersome.
2. **Multiple registrations** – The law currently requires companies having operations in multiple states to have a separate registration for each state. This tends to be cumbersome and increases the compliance costs for large companies, while being a deterrent for small and medium sized companies to scale-up.
3. **Exemption from compulsory registration in case of sellers on e-commerce sites** - In case of an assessee selling through an e-commerce site, registration is compulsory under section 24(ix). This increases the compliance burden especially for small assesseees.
4. **Cancellations/ Restoration of cancellations** – The CGST Act, 2017 lays down that registration may be cancelled if the registered person has not furnished returns for a continuous period of six months. Assesseees have been facing issues of suspension of registrations, Suo-moto cancellations, etc. wherein the Department may have taken action without proper intimation to the assessee, as prescribed in the law. Since the entire business value chain is interconnected for the purpose of GST compliances, one vendor's cancellation often disrupts the compliance and ITC of the entire value chain.

### Challenges with Clarity of rules and regulations

**Classification of goods** - Given the current multiple rates in GST, the classification of different categories of goods under the HSN codes and arriving at the applicable GST rate becomes a challenge for many companies. For example, there are contrary rulings with respect to the classification of electric vehicles (two-wheeler or three-wheeler) without battery. As per Odisha AAR, the two or three-wheeled “battery powered electric vehicle” when supplied with or without battery pack is classifiable under HSN 8703 as an ‘electrically operated vehicle’ and is taxable at 5% GST. However, as per West Bengal AAR, electric vehicles (two-wheeler or three-wheeler) without battery is as good as chassis fitted with an engine of a vehicle and thus, the same is classifiable under HSN 8706 and taxable at the rate of 28%. **Frequent changes, circulars and notifications causing tax fatigue** - Given the colossal scale and size of the reforms ushered by GST, it has been a steep learning curve for taxpayers as well as the administration. In its efforts to ease the complications in the system, the GST Council undertook numerous changes in the first two years. The frequent changes in legal provisions, procedures, rates, and the IT platform (over 150 a year<sup>13</sup>), though largely beneficial, increased the compliance burden of taxpayers. Businesses often face challenges comprehending frequent changes, circulars and notifications issued by the Government from time to time. There is a lack of a master circular or consolidated e-book of changes in GST, the way it exists for the Companies Act amendments. Hence to understand a change, one often has to look up previous amendments to make sure nothing has been missed.

## 2. GST Returns

Salient features of the return mechanism under GST includes electronic filing of returns, uploading of invoice level information, auto-population of information relating to ITC from supplier’s returns to that of recipient, invoice level matching and auto-reversal of ITC in case of a mismatch.

A GST return is a document containing details of all income/ sales and/or expense/ purchase which a taxpayer (every GSTIN) is required to file with the tax authorities. This is used by tax authorities to calculate net tax liability. All registered businesses must file monthly or quarterly and an annual GST return based on the type of business.

### Monthly or Quarterly GST returns

Any regular business having more than INR 5 crore (≈ GBP 0.50 Mn) as annual aggregate turnover must file two monthly returns viz. return for reporting outward supplies (i.e., FORM GSTR-1) and return for reporting summarized details of outward supplies and input tax credit (i.e., Form GSTR-3B).

To ease out the compliances of small taxpayers, whose turnover is less than INR 5 crores (≈ GBP 0.50 Mn), CBIC introduced a Quarterly Return Filing and Monthly Payment of Taxes (QRMP) scheme under GST. The QRMP scheme allows the taxpayers to file GSTR-3B on a quarterly basis and pay tax on a monthly basis. Additionally, taxpayers having an aggregate turnover of up-to INR 1.5 crores (≈ GBP 0.15 Mn) have an option to file a statement of outward supplies on a quarterly basis. However, an invoice furnishing facility is available to them on a monthly basis (if opted for QRMP) so that it can be auto populated in the input tax credit statement of the recipient on a monthly basis instead of quarterly.

Separate returns have also been prescribed for a taxpayer registered under the composition scheme, non-resident taxpayer, taxpayer registered as an ISD, a person liable to deduct or collect the tax (TDS/TCS) and a person granted a Unique Identification Number. Figure 5 illustrates the process of GST returns compliance.

### Challenges faced while filing returns

- a) **No option for revision of return** – Under the GST law, no mechanism has been provided to the taxpayer to revise the return once it has been filed. In some cases, there are genuine errors/ mistakes that occur while filing returns and an opportunity to file amended/ revised returns (as is allowed in Income Tax and was also allowed in previous indirect tax laws) should be provided to the assessee. Currently, a facility has been provided to make adjustments in the subsequent returns, thus, making the entire process complex.
- b) **Payment of GST on receipt basis** - An assessee has to pay GST upon raising an invoice irrespective of whether the customer has paid. This is a huge working capital cost for MSMEs.
- c) **GST liability on inter-branch supply** - The GST provisions mandate the payment of GST on inter-branch supply of services (e.g., common services provided by a head office to its branch offices). In such a situation, while the branch is eligible to avail the credit of the same, it impacts the working capital of the company.

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<sup>13</sup> Reimagining GST@3, PwC available at <https://www.pwc.in/assets/pdfs/trs/gst/reimagining-gst-3.pdf>

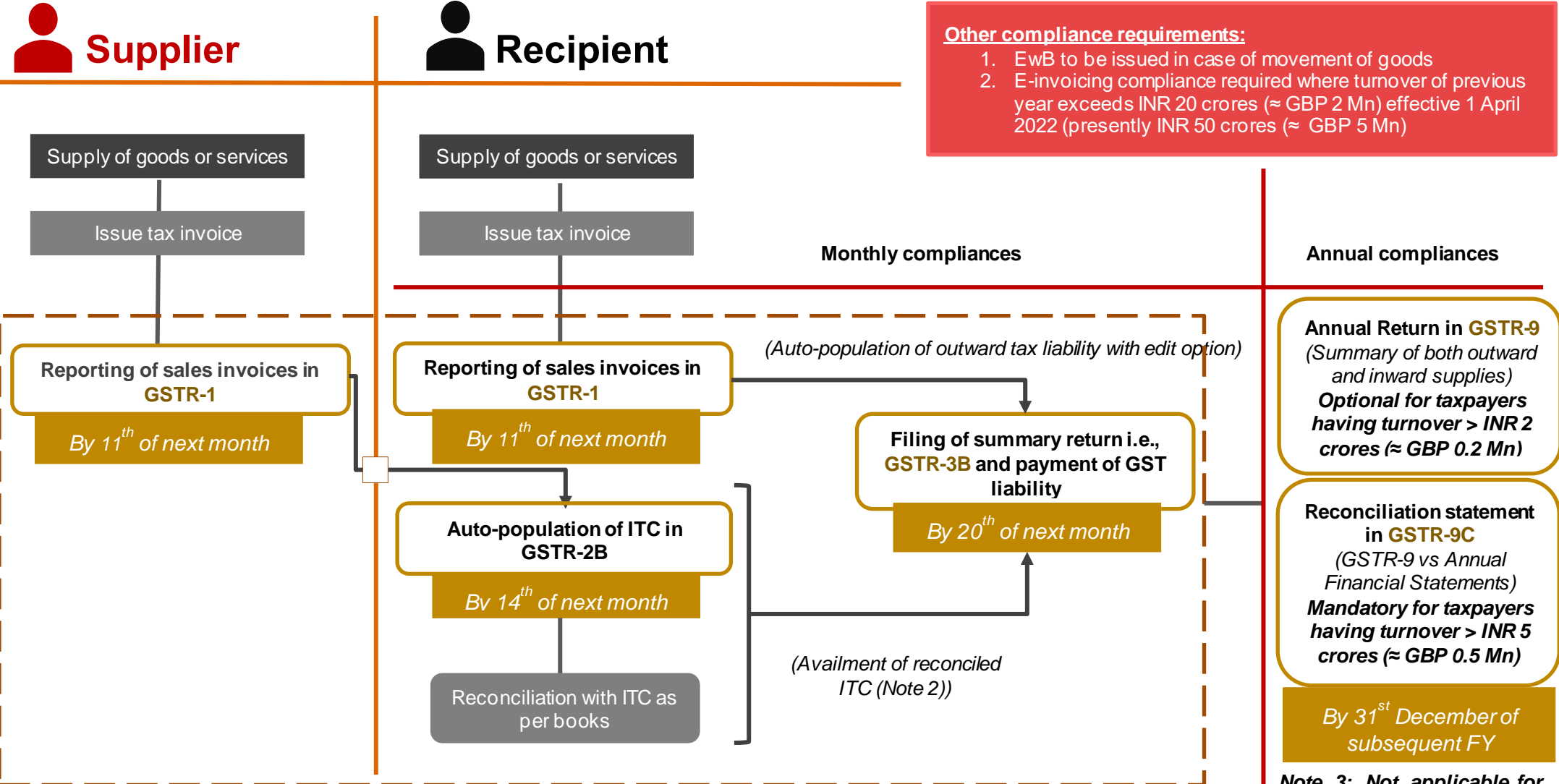
Further, such GST liability on inter-branch supply does not generate any additional revenue for the government in cases where the recipient is eligible to take entire credit.

- **Payment of GST on Ocean freight** - Firms importing goods to India face a challenge as the tax department seeks to recover GST on ocean freight charges (in addition to Customs duty on CIF basis) for such imports through a "reverse charge mechanism". Recently, this issue has been decided by Supreme Court<sup>14</sup>, wherein, it has been held that no GST shall be levied under reverse charge mechanism on ocean freight charges in case of CIF contracts. However, the issue that arises now is that whether the taxpayers can claim refund or take adjustment of the GST so paid for past periods.

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<sup>14</sup> In the case of Mohit Minerals Private Limited

Figure 5 Compliance requirements under GST



**Note 1:** The above mechanism is applicable for registered persons having turnover exceeding INR 5 crores (≈ GBP 0.5 Mn) in previous financial year

**Note 2:** In Budget 2022, the government also proposed certain additional conditions on the ITC availment basis the vendor's default. The same are discussed in detail in the Annexure

**Note 3:** Not applicable for ISD, TCS collector, TDS deductor, casual taxable person, non-resident taxable person

Source - Section 37,38,39,44 and 68 of CGST Act, 2017 read with Rule 36,48 and 138 of CGST Rules, 2017

### 3. ITC Matching

The details of outward supplies submitted by the taxpayer in the GSTR-1 shall be auto-populated in the input tax credit statement of the recipient i.e., GSTR-2A/ GSTR-2B basis which the recipient avails the ITC. This mechanism prevents revenue leakage and facilitates availment of eligible ITC by taxpayers.

The broad framework of the GST return mechanism has been summarized as under:



#### Challenges with ITC

- a) **Dependency on vendors for ITC matching** – Companies are dependent on their vendors and suppliers to upload their returns correctly and in a timely manner to receive their input credit. ITC is only available to the recipient if the same is reported by the supplier in its outward return<sup>15</sup>. Companies are facing blockage of input tax credit because of issues in matching ITC of vendors who delay the return filing process, mismatch in reporting by the suppliers; and companies don't have visibility on whether the supplier has paid tax because GSTR Form 1 and 3B are not linked. Further, a new provision<sup>16</sup> has been introduced in the Finance Act 2022, where ITC of the recipient would get further restricted for non-compliances on the part of the supplier such as in case of a continued default by the supplier in tax payment or where the ITC availed by him exceeds the ITC under his auto-generated statement. The stringent provisions for availing ITC give rise to a host of issues for businesses, such as negative impact on working capital, higher compliance burden, delays due to dispute resolution and added costs on the output supplies. This also has a major impact on MSMEs who already face working capital issues. The amendments introduced in the Finance Act 2022 would render the ITC provisions even more restrictive.
- b) **Blocking of ITC** – The Department resorts to blocking of ITC under rule 86A in case of any apprehensions of incorrect or ineligible availment of ITC. This blocking continues for long periods (up to a maximum period of a year as permitted under the Rule). The assessee faces challenges because of this clause since neither the Department issues a Notice (DRC 01) against which the assessee can go for adjudication nor the Department readily accepts the submissions of the assessee for unblocking. In fact, it has been observed that the Department does not have any SOP for unblocking and the requirements differ from officer to officer and Department to Department. This poses huge challenges to the assessee who has to pay GST in cash wherein the ITC remains blocked. Small businesses are most affected by such practices of ITC blocking by the tax authorities.
- c) **Transfer of ITC in case of sale, transfer, etc.** – The IGST Act allows for transfer of unutilised ITC in case of sale, transfer, etc. from one state to another. However, the same is not enabled on the GSTIN and the website does not allow the transfer of unutilised ITC of IGST between states and insists that the transferee state should be the same as transferor state. This needs to be taken up by the Department and suitable amendments are needed in the system.
- d) **Reversal of ITC in case payment if not done within 180 days** – As per GST laws, in case invoices are not paid within 180 days, the assessee has to reverse the ITC and then it can be reclaimed once the payment is done. This creates a problem for the companies where the payment terms range over six months and are linked with certain events

### 4. Annual returns

In addition to the above, taxpayers having an aggregate turnover of more than INR 2 crores ( $\approx$  GBP 0.20 Mn) are required to file annual returns in Form GSTR-9, which contains the consolidated summarized details of monthly/

<sup>15</sup> Outward return basically refers to the GST return filed by a supplier for any 'outward supplies' which under the CGST Act is defined as - "outward supply" in relation to a taxable person, means supply of goods or services or both, whether by sale, transfer, barter, exchange, license, rental, lease or disposal or any other mode, made or agreed to be made by such person in the course or furtherance of business. In simple terms, this refers to sales by a supplier.

<sup>16</sup> This provision is yet to be made effective as of May 2022

quarterly returns. Further, a reconciliation statement (i.e., reconciliation between financial statements and annual return) is to be filed in form GSTR-9C if aggregate turnover of a taxpayer exceeds INR 5 crores ( $\approx$  GBP 0.50 Mn).

However, this requirement increases the compliance burden for MSMEs and could be relaxed for assesseees whose Aggregate Annual Turnover is up to INR 5 crores ( $\sim$ GBP 0.5 million).

## 5. E-invoicing & E-way Bill

Electronic invoicing is a system in which Business to Business (B2B) invoices are authenticated electronically by Goods and Services Tax Network (GSTN) for further use on the common GST portal. Under the E-invoice system, an identification number is issued against every invoice by the Invoice Registration Portal (IRP) that is managed by the National Informatics Centre (NIC). At present, e-invoice is applicable for the taxpayers having aggregate turnover of more than INR 20 crores ( $\approx$  GBP 2 Mn).

A waybill is a receipt or a document issued by a carrier giving details and instructions relating to the shipment of a consignment of goods and includes details of consignor, consignee, point of origin of the consignment, its destination and route. E-way Bill is a compliance mechanism, whereby using a digital interface, the person causing the movement of goods uploads the relevant information prior to the commencement of movement of goods and generates an e-way bill on the GST portal. This is mandatory for the movement of goods having consignment value of more than INR 50,000 ( $\approx$  GBP 500). However, there are certain states which have provided different limits such as in Tamil Nadu, E-way Bill is required for intra-state movement of goods having consignment value of more than INR 100,000 ( $\approx$  GBP 1000).

### Challenges with e-way bills

- a) **Penalties for small errors in e-way bills are disproportionately high** - In case of small mistakes or technical errors in the e-way bill, assesseees have to pay a penalty of INR 1000<sup>17</sup> (GBP 10). There also exists some amount of harassment by officials at state borders. This is a problem, especially for MSMEs as they have to deal with detention of vehicles, seizure of goods, delays in the supplies and disruption in the supply chain.
- b) **Expiry of e-way bill** – Sometimes, the validity of e-way bills expires due to breakdown of vehicles, transport during holidays, etc. Such delays may not always be communicated by the truck driver in time, as a result of which the e-way bill validity expires which is subject to a penalty.

## 6. Interest & penalty for non-compliance

Under the GST law, interest and penalties have been prescribed at various instances for non-compliance in obtaining registration, non-filing of returns etc. Some of these are mentioned below:

- Failure to obtain registration attracts a penalty of INR 10,000 ( $\approx$  GBP 100) or 10% of tax due, whichever is higher.
- Late payment of GST – Interest at the rate of 18 percent is levied on the late payment of taxes under GST. The interest is levied for the days for which the tax was not paid from the due date.
- Late filing/non-filing of GST returns – Where a taxpayer does not file returns within the due dates, he/ she shall be liable to a late fee of INR 200 (i.e., INR 100/- ( $\approx$  GBP 1) for CGST and INR 100 ( $\approx$  GBP 1) for SGST) per day (up to a maximum of INR 5,000/- ( $\approx$  GBP 50)) from the due date to the date when the returns are actually filed.

### Challenges

**Unduly high interest rates** - Presently in case of delay in payment of GST or wrong availment as well as utilization of ITC, interest at the rate of 18 percent is payable which is relatively high. In case of an assessee whose Aggregate Annual Turnover is up to 5 crores relief maybe allowed by way of a reduced interest rate of 6 percent.

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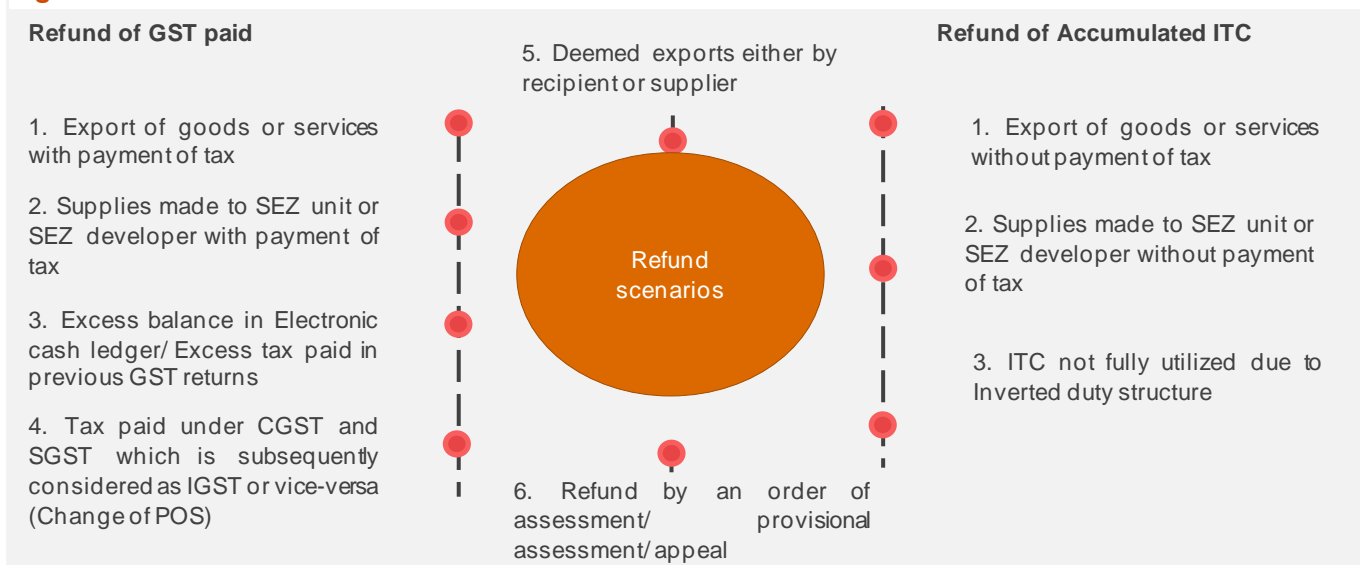
<sup>17</sup> Vide Circular No. 64/38/2018-GST dated 14 September 2018

## 7. GST Refunds

The concept of refund under GST relates to the amount returned by the government in specified scenarios such as tax paid on exports, accumulated ITC, tax amount paid either in excess etc. Timely refund mechanism is essential in tax administration, as it facilitates trade through release of blocked funds for working capital, expansion, and modernization of existing business. Hence, government has released standardized process for GST refunds.

There are various scenarios which require a registered taxpayer to claim GST refund from the government. The same are depicted in.

**Figure 6: Tax Refund scenarios**



Some of the important scenarios are discussed in detail below:

**a) Export of Goods or Services and supplies to SEZs units and developers** - One of the major categories under which registered taxpayers claim GST refund is zero rated supplies (viz. Export of goods or services or both and Supply of goods or services or both to a SEZ developer or unit). A person claiming GST refund on account of zero-rated supplies can use one of the following options:

- Supply of goods or services without payment of tax under Letter of Undertaking (LUT) or a bond and claim a refund on the ITC accumulated on account of inputs/ inputs services used in making such supplies
- Supply of goods or services with payment of tax and claim refund of the same

In case of refund of unutilized ITC, provisional refund amounting to 90% of the total amount of the refund due is granted within 7 days from the date of acknowledgement.

**b) Deemed Export** – This refers to supply of goods manufactured in India (and not services) which are notified as deemed exports under the GST law, such as supply of goods to Export Oriented Unit (EOU), Electronic Hardware Technology Park (EHTP) or Software Technology Park (STP). The refund for tax paid on supplies considered as deemed exports is claimed either by the supplier or the recipient. However, the supplier of deemed exports can file the refund application in situations where the recipient does not take the benefit of ITC on such supplies and the recipient gives an undertaking that the supplier can take such refund.

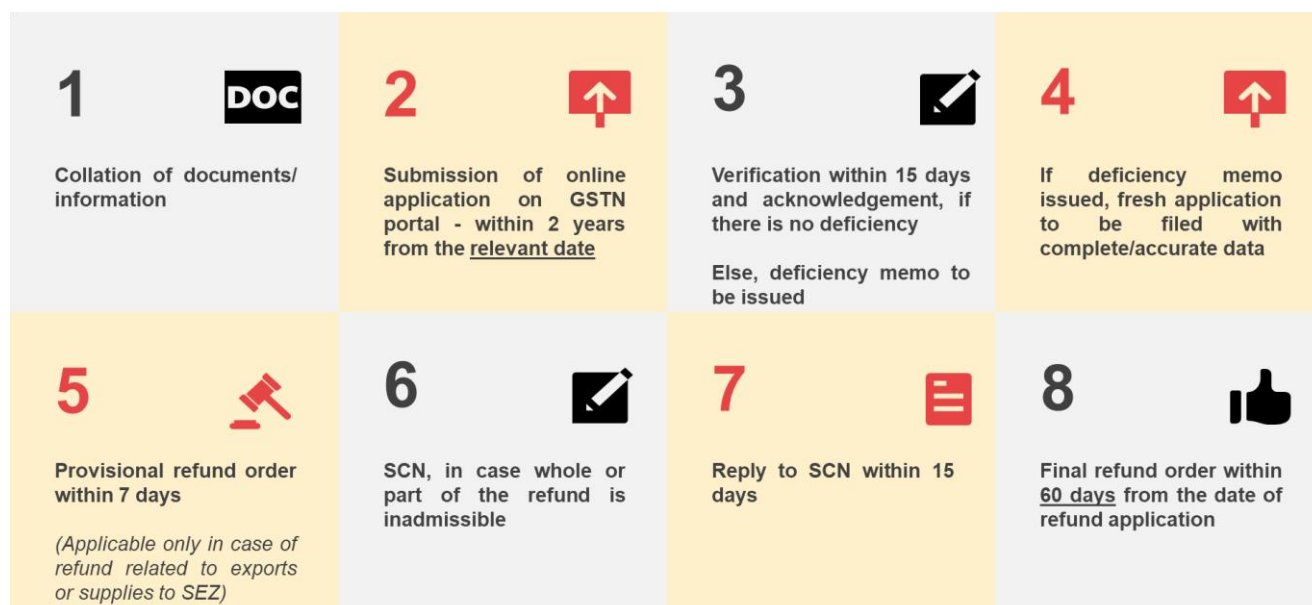
**c) Refund of accumulated ITC on account of inverted duty structure** – As mentioned above, inverted duty structure refers to a scenario where the amount of credit accumulates on account of rate of tax on inputs being higher than rate of tax on output supplies. In such situations, the supplier can claim the refund of ITC.

However, refund of accumulated ITC in case of inverted duty structure is not allowed in the following cases:

- where output supplies are nil rated or wholly exempt.

- against supply of goods or services as may be notified by the government on the recommendations of the GST Council.

Figure 7 An illustrative refund application process



Note 1 – The above mechanism is not applicable for refund in case of export of goods

Note 2 - In case, the refund is not paid to the applicant within 60 days, interest @ 6 percent to be paid to the applicant

### Key challenges under GST refund

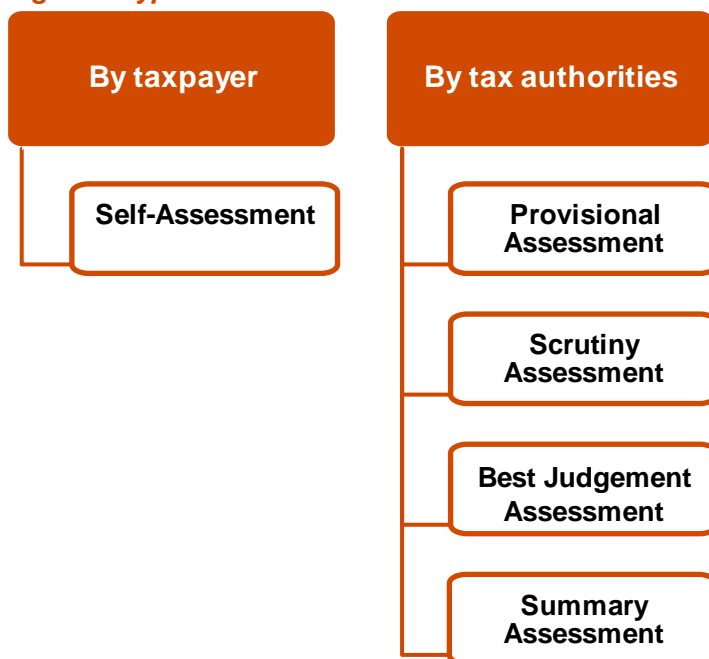
In the recent past, taxpayers have faced certain challenges in filing and processing of refund applications. Some of the key challenges have been mentioned below:

- a) **Not granting provisional refund** – As mentioned above, in case of refund on account of zero-rated supply of goods or services or both, refund on a provisional basis (90% of the total amount so claimed) is to be granted within 7 days of giving the acknowledgment subject to prescribed conditions. However, in a few cases it has been observed that the department does not grant any provisional refund and directly issues the final order/ show cause notice (SCN) thus impacting the working capital of the taxpayers.
- b) **Demanding documents/information not prescribed under the law for the purpose of GST refund** - In certain cases, it has been observed that the department demands for documentation and information which is not prescribed under the law. Consequently, the total time of refund processing and compliance burden on the companies increases.
- c) **Difficulty in getting refund from state due to incorrect place of supply** - Where a taxpayer pays CGST & SGST/UTGST on a transaction considered by him to be an intra-State supply but the same is subsequently held to be an inter-State supply, the taxpayer is required to make a fresh payment of IGST to the correct state and obtain a refund of the tax paid to the wrong state. Likewise, where a taxpayer pays IGST on a transaction considered by him to be an inter-State supply but the same is subsequently held to be an intra-State supply, he is required to make a fresh payment of CGST & SGST/UTGST and obtain a refund of the tax wrongly paid. Many registered persons face the issue of paying wrong taxes on account of declaring the wrong place of supply.
- a) **Lack of uniform State level guidelines/mechanism for refund processing** - Certain states have issued state specific guidelines for processing of refunds. This goes against the expectation that there will be uniformity in law and procedures across States on introduction of GST.

For instance, the state of Tamil Nadu through a recent circular<sup>18</sup> in September 2021 has implemented Faceless Refund Module, where, for any assessee under State jurisdiction, the refund has to go through a faceless refund processing scheme. This faceless refund module automatically assigns an officer on a random basis and allots the refund claims filed. Thereafter, refund processing is taken up. While there are some advantages in the faceless refund scheme, the primary issue is variation in the manner of processing of GST refund by States.

- b) **Inadequate state capacity in tax administration** - State Tax Authorities are more accustomed to State specific VAT Laws that existed for more than a decade before GST regime and therefore follow procedural mechanisms as existed in erstwhile VAT laws. There is also a lack of adequate training and sensitization towards taxpayer facilitation. Manpower is also limited, and officers are tasked with various matters in parallel. This, at times, leads to inordinate delays in processing of refund claims.
- c) **Limited scope of refund on account of accumulated input tax credit** - The scope of the refund on account of accumulated ITC is limited to two scenarios namely, export and inverted duty structure. However, there are various situations wherein accumulation of ITC is suffered, and no liquidation is allowed under the refund provisions. This creates hassles of blocked cash and interest loss for taxpayers.
- d) **Delay in re-credit of rejected refund** – In case of refund cases that are rejected, the recredit of the same needs to be done in the Electronic Credit Ledger on furnishing of undertaking. As no timeline is mentioned in the law for re-credit, it is not being issued in a time-bound manner.
- e) **Refund of ITC in case of exports when the assessee does not have domestic sales** – In case of refund of ITC in case of exports, the value of exports is taken at 1.5 times of the domestic value of the goods. However, in cases where the company does not have any domestic sale, the comparison with export value and calculation of 1.5 times becomes difficult. Refunds are being rejected for non-compliance on this issue, which becomes difficult to comply with.
- f) **Demand for payment of refund received by the assessee in case of investigation by other agencies** – It has been noticed that in case refund is sanctioned by the GST Department and there is an investigation by any other agency, for e.g., Directorate of Revenue Intelligence (DRI), the GST Department raises a demand seeking repayment of the refund without following the due process of law and without waiting for any outcome of the investigation. Thus, the assessee is left to deal with two fronts i.e., one with the investigating agency e.g., DRI and other with the GST Department.
- g) **Refund for taxpayers with ‘Risky Exporter’ tag** – In some cases, where the Department has tagged the assessee – exporter as a ‘risky exporter’, it has become difficult for the assessee to get the tag removed and get GST refunds on time. The assessee does not have access to information for the basis of the assigned tag and in some cases, the tag is assigned incorrectly. CBIC has provided an

**Figure 8 Types of Assessments**



<sup>18</sup> Circular No: 22/2021 – TNGST (PP2/GST- 15/24/2021)

SOP<sup>19</sup> to be followed by exporters to expedite the verification and release GST refunds in time. However, the verification process takes longer than the prescribed period of 14 days.

## **8. Assessments**

Under GST, assessment means determination of tax liability. GST is a trust-based taxation regime, wherein, the assessee is required to self-assess his tax liability and furnish returns by declaring the taxable turnover, tax payable or refundable, ITC availed, etc. This mechanism is known as Self-Assessment. Apart from Self-Assessment, there are other types of assessment which are done by tax authorities.

### **A. Provisional Assessment**

The major determinants of the tax liability are generally the applicable tax rate and the value. There may be situations when these determinants are not readily ascertainable and may be subject to the outcome of a process that requires deliberation and time. Hence, in circumstances where it is not possible to carry out an assessment and determine the exact duty liability, the GST law provides for a mechanism of provisional assessment.

In such a case, the supplier can request the Assistant Commissioner/ Deputy Commissioner of Central Tax in writing, giving reasons for payment of tax on a provisional basis. The supplier requesting for payment of tax on a provisional basis has to furnish an application along with the documents in support of his request, electronically in prescribed form on the common portal.

### **B. Scrutiny Assessment**

The proper officer may scrutinize the return and related particulars furnished by the registered person to verify the correctness of the return and inform him of the discrepancies noticed. In case no satisfactory response is received within thirty days of being informed by the proper officer or such further period as permitted by the officer, the proper officer has powers to initiate audit or inspection/ search /seizure or demand/ recovery of short payment of tax. It is to be noted that provision of this Assessment is applicable only where return is filed by the registered person.

### **C. Best Judgement Assessment**

Where a registered person fails to furnish the GST returns, even after the service of a notice, the proper officers may proceed to assess the tax liability of the said person to the best of their judgement. The liability is computed considering all the relevant material which is available with the department or which has been gathered from the taxpayer. Officers can only issue an assessment order within five years from the due date of the annual return for the year when the tax was not paid.

### **D. Summary Assessment**

On any evidence showing the tax liability of a person that has come to notice and where there are sufficient grounds to believe that any delay may adversely affect the interest of revenue, the proper officer may proceed to assess the tax liability of such person. Prior approval of Additional Commissioner or Joint Commissioner shall be required for such assessment.

### **Key challenges faced by taxpayers during assessments**

- a) **Assessment under dual Jurisdictions** - One of the key challenges under GST is dual jurisdiction, which has complicated the tax system and created challenges for the taxpayers. At present, Section 6 of the CGST Act provides the power of cross empowerment where Central GST officers can have jurisdiction under State GST and vice-versa for processing and grant of refunds. However, this provision has been referred to cover cases relating to investigation also. Because of this, there have been instances where the taxpayers have been subject to dual proceedings/ investigations for the same matter/ same period before multiple authorities.

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<sup>19</sup> <https://www.cbic.gov.in/resources/htdocs-cbec/gst/circular-cgst-131.pdf;jsessionid=C2490F17762492C8827EE2B262DAD3BE>

Sometimes, notices also get issued from Directorate General of GST Intelligence (DGGI) and Jurisdictional Officers on similar issues.

- b) **Delay in constitution of the GST Appellate Tribunal** - The constitution of the GST Appellate Tribunal has been delayed by four years since the promulgation of GST. The constitution of National and other Benches of appellate tribunal under Section 109 of the CGST Act has become an absolute necessity since currently taxpayers aggrieved of the orders passed by appellate/revisional authority are forced to approach the respective High Courts by way of writ petitions for matters relating to refund or recovery. This is due to the absence of an appellate tribunal and the same is overburdening the High Courts as well<sup>20</sup>.
- c) **High cost of pre-deposit for filing appeals** - In case an appeal has to be filed before the Appellate Authority or GST Appellate Tribunal, a pre-deposit of 10% (up to a maximum of 50 crores) is required in 1st appeal and a pre-deposit of further 20% (up to a maximum of 100 crores) is required in 2nd appeal. This is a huge cost to small assesseees and a working capital blockage, especially when the dispute is due to miscommunication due to technical errors and is of a minor value.
- d) **Need for National Appellate Authority for Advance Ruling (NAAAR)** – With the objective to avoid disputes between the taxpayers and revenue department, the provision of advance rulings was introduced under the GST law. However, advance rulings are only applicable to the company which received the ruling, not the entire sector. Thus, tax officers might choose to impose a different rate on the other companies of the same sector/product category. Furthermore, each state has its own AAR and AAAR which sometimes provided different advance rulings on similar matters. This also creates a lot of uncertainty for companies. Therefore, there is a need of setting up the NAAAR as a centralized authority for advance rulings.
- e) **Time bound completion of audits and assessments** – Assesseees are facing issues with long continuing audits and assessments by the Departments. The audits and assessments do not end within the specified time-period in the law. This results in continuous demand of data and documents by the Department's team. Further, once the audit is complete, there is no communication from the Department about completion of audit.
- f) **Data being sought in a roving enquiry**– Some tax authorities are seeking data on a very regular basis through emails e.g., reconciliation between 2A and 3B, reconciliation of debit and credit notes, etc. and not by invoking any specific section. In some cases, data is being sought only by mentioning rule 56(18) which is a rule that mandates maintenance of books of accounts by an assessee and that they should be produced on demand. However, whether the officer seeks to do an assessment, audit, investigation, etc. is not being mentioned. This increases the time and cost of compliance for the assessee.
- g) **Lack of data-driven risk-based targeted scrutiny** – Assessments are a low priority for the states and sometimes assessments get merged with the audit process. Currently, departments have the power to scrutinize every case. Hence, they apply scrutiny on low-risk cases as well which cause delays and unnecessary notices for taxpayers. Data driven risk assessment methods need to be used to scientifically target and scrutinize high risk cases only. DGARM in CBIC is in charge of this function and conducts spike analysis to spot anomalies. States and zonal officers are also taking steps to integrate technology-based applications to bring efficiency in scrutiny and assessment<sup>21</sup>. More data collection on GST can aid this process as well as handholding on advanced data analytics. Cost and timelines of GST compliance

As mentioned in the previous sections, there has been a significant improvement in the indirect tax compliance as compared with the regime prior to GST in the country. However, there remain certain challenges that the taxpayers continue to face due to the complexity of legislation. This contributes to the time and costs of undertaking compliance activities. The table below is a rough estimate of the burden of this compliance for the

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<sup>20</sup> The Supreme Court in *Amit Sahni v/s Union of India* has also raised the issue to the Centre for not constituting an appellate tribunal under the CGST Act even after four years of the Act having come into force.

<sup>21</sup> <https://www.cbic.gov.in/resources/htdocs-cbec/chairman-newsletters/newsletter-04Apr2022.pdf>

taxpayer for the purpose of registration, compliances and refund based on primary interviews with a sample of 20 companies.

**Table 4: Cost and Timelines of GST Compliance**

Turnover category	Particulars	GST registration	Monthly GST Compliances	GST refund
Turnover > GBP 10 Mn < GBP 50 Mn	Average time incurred by taxpayer	1-2 days (for purpose of collation of information/ documents and submission of application)	8-10 hours per registration per month	10-15 days
	Average time taken by GST authorities	7-15 days to process application	NA	40-60 days
	Average cost incurred by taxpayer	INR 5000 – INR 25000 (GBP 50.15- GBP 250.75)	INR 8000 – INR 12000 (GBP 80.24-GBP 120.36)	Generally, it ranges between 0.5%-2.5% of refund
Turnover > GBP 50 Mn	Average time incurred by taxpayer	1-2 days (for purpose of collation of information/ documents and submission of application)	6-8 hours per registration per month	10-15 days
	Average time taken by GST authorities	7-15 days to process the application	NA	40-60 days
	Average cost incurred by taxpayer	INR 5000 – INR 25000 (GBP 50.15- GBP 250.75)	INR 15000 – INR 20000 (GBP 150.45-GBP 200.60)	Generally, it ranges between 0.5%-2.5% of refund

**Assumptions/ basis of computation of Costs & Timelines**

- The computation in Table 4 is based on a sample of size of 20 companies from different sectors such as Engineering products, Healthcare, E-commerce, Auto, Pharma, etc.
- The time and cost incurred by the taxpayer for the purpose of registration, filing, compliances and refund have been computed basis the average of time incurred by the taxpayers under different turnover categories. It is to be noted that time and cost mentioned above includes only the time and cost incurred by third party consultants hired by taxpayers. In the absence of information, the time and cost spent by the Company’s in-house team has not been considered.
- It is also to be noted that such third-party consultants are using technology tools for GST compliances which minimize interface with government websites and would bring down the time and cost normally incurred for GST compliances.
- For registration, there is a set procedure laid down in the law. Hence, no variance has been observed in the time and cost element for obtaining new registration
- Time and cost involved in Annual GST compliances has not been considered for the above analysis

- The time and cost of GST refund is computed basis the time and cost of different GST refund scenarios such as refund of unutilized input tax credit on account of zero-rated supplies, refund on account of inverted duty structure, refund of tax paid on export of services or services to SEZ unit, etc. This does not include refund of IGST paid on export of goods as no separate refund application is to be filed in such cases.

## 4. Workstream 2: Impact Estimation

Under the Goods and Services Tax (Compensation to States) Act 2017, the centre is required to compensate the states for any shortfall in their tax revenue collection from GST as compared to the projected revenue from taxes subsumed under GST that may arise from the transition into the new GST regime. As explained in section 2.2, the shortfall is calculated assuming a fixed growth rate of 14% on the base year (2015-16) collections from all the taxes subsumed under GST. It was agreed that such revenue shortfalls would be compensated for five years which ends in June 2022. The imminent end of GST compensation paid to states could adversely impact state finances given the amounts involved.

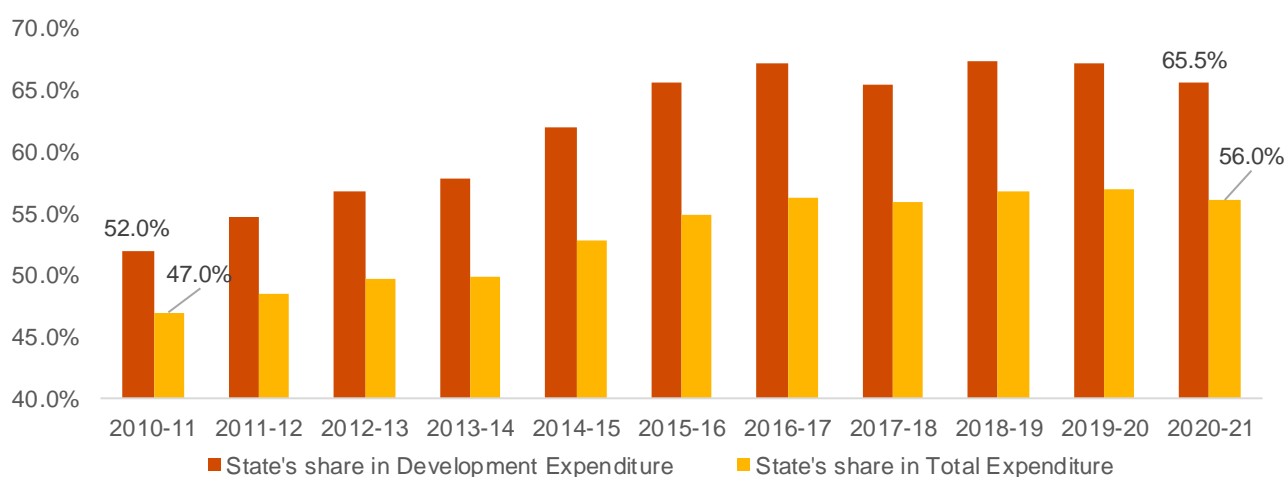
In this chapter, section 4.1 outlines the role of states in development spending, significance of GST revenues for states, their fiscal situation, and their progress towards sustainable development. Section 4.2 highlights the extent to which states' revenues would be impacted by the ending of the GST compensation cess. Section 4.3 estimates the potential impact on development spending consequent to the revenue loss post June 2022.

### 4.1. State level assessment

As per the Seventh Schedule of the Constitution of India, states have powers to make laws on 66 subjects under the State list which include agriculture, public health and sanitation, irrigation, water supply, road transport, and several others.<sup>22</sup> States also share power with the centre over 47 subjects in the Concurrent list including education, forests, trade unions, social security. This has given States the responsibility of a higher proportion of welfare expenditure and over the past decade the combined expenditure of all the states has exceeded that of the Centre.

Since 2010-11, share of States in development expenditure as well as total expenditure has increased. In 2010-11, States' share in development expenditure was 52 percent which has increased to 65 percent in 2020-21. Similarly, States' share in total expenditure was 47 percent in 2010-11 which has increased to 56 percent in 2020-21 (Figure 9). This could be attributed to increase devolution of taxes to states post 14<sup>th</sup> Finance Commission and continued in 15<sup>th</sup> Finance Commission.

**Figure 9: State's share in development expenditure and total expenditure (In percent)**

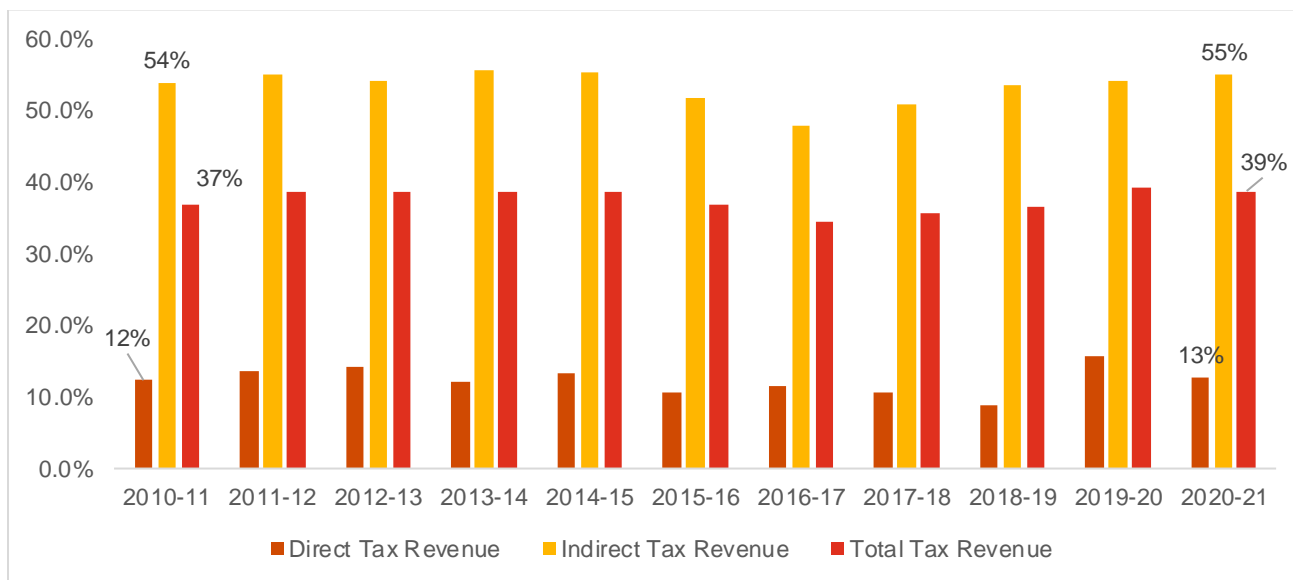


Source: Handbook of Statistics on Indian Economy (<https://www.rbi.org.in/scripts/PublicationsView.aspx?id=20510>)

<sup>22</sup> Seventh Schedule, Constitution of India availed at <https://www.mea.gov.in/Images/pdf1/S7.pdf>

As can be seen from Figure 10 states' share in total revenues has remained stable over the last decade. State revenue in this graph does not include transfers from the centre in the form of divisible pool of taxes. States are responsible for higher expenditure obligations as shown in the preceding graph relative to revenue share of 39 percent in 2020-21. To address this vertical fiscal imbalance, the Central Finance Commission recommends transfers from centre to states both through divisible pool of taxes as well as grants.

**Figure 10: States' share in direct, indirect, and total tax revenue (in percentage)**



Source: Handbook of Statistics on Indian Economy (<https://www.rbi.org.in/scripts/PublicationsView.aspx?id=20509>)

It is noteworthy to mention that relative to direct tax revenues, states have a larger share in indirect tax revenues at 55 percent in 2020-21. This is expected as key direct taxes such as personal income tax and corporate income tax are levied and collected by the Centre.

Table 5 shows distribution of revenues of states and UTs in 2020-21. GST collections form nearly 29 percent of total revenue receipts of All States and UTs. This includes SGST (19 percent), GST compensation (4 percent), and transfers from the Centre out of CGST (7 percent). If we discount the GST compensation as it would be discontinued post June 2022, the SGST and CGST transfers through divisible pool of taxes would together constitute nearly 26 percent of total revenue receipts of All States and UTs. Therefore, any reforms on improving GST administration would strengthen funding available at the state level significantly and contribute towards development spending in States.

**Table 5: Distribution of revenue of states and UTs in 2020-21 Revised Estimates, In INR crore**

Item	2020-21 All States and UTs	As percent of Total Revenue Receipts
<b>Revenue Receipts (I+II)</b>	<b>2,790,984</b>	<b>100%</b>
<b>I. TAX REVENUE (A+B)</b>	<b>1,831,093</b>	<b>66%</b>
<b>A. State's Own Tax Revenue (1 to 3)</b>	<b>1,241,117</b>	<b>44%</b>
1. Taxes on Income	6,217	0%
2. Taxes on Property and Capital Transactions	135,242	5%

Item	2020-21 All States and UTs	As percent of Total Revenue Receipts
3. Taxes on Commodities and Services	1,099,659	39%
of which		
i) Sales Tax	291,038	10%
ii) State Excise	174,917	6%
iii) Taxes on Vehicles	60,682	2%
iv) Taxes on Goods and Passengers	2,325	0%
v) Taxes and Duties on Electricity	48,142	2%
vi) Entertainment Tax	25	0%
<b>vii) SGST</b>	<b>518,726</b>	<b>19%</b>
viii) Other Taxes and Duties	3,806	0%
B. Share in Central Taxes	589,976	21%
of which		
i) Corporation Tax	172,736	6%
ii) Income Tax	170,969	6%
iii) Customs	37,698	1%
iv) Union Excise Duties	23,880	1%
v) Service Tax	1,040	0%
<b>vi) CGST</b>	<b>183,535</b>	<b>7%</b>
<b>II. NON-TAX REVENUE (C+D)</b>	<b>959,890</b>	<b>34%</b>
C. State's Own Non-Tax Revenue	211,453	8%
D. Grants from the Centre	748,438	27%
<b>of which: GST compensation</b>	<b>113,110</b>	<b>4%</b>

Source: State Finances-A Study of State Budgets, Reserve Bank of India

While GST revenues do constitute a significant portion of revenue receipts, in the recent years post COVID-19, fiscal indicators at the state level have deteriorated. The fiscal deficit which remained largely below 3 percent (except in 2016-17 and 2015-16) has gone up to 4.7 percent in 2020-21 RE and 3.7 percent in 2021-22 BE. This is closely attributable to the onset of the COVID-19 pandemic. This has led to build-up of debt. Outstanding liabilities as percent of GSDP has increased from 25.3 percent in 2018-19 to 31.2 percent in 2021-22 BE. This highlights the increasing fiscal stress at the state level. Discontinuation of GST compensation post June 2022 would impact state revenues. This would put additional pressure on state finances and unless state governments make adjustments in public spending, outstanding liabilities may go up further.

**Table 6: Key fiscal indicators of All States**

Year	Gross Fiscal Deficit	Revenue Deficit	Primary Deficit	Outstanding Liabilities as percent of GSDP
2010-11	2.10	0.00	0.50	23.50
2011-12	1.90	(0.30)	0.40	22.80
2012-13	2.00	(0.20)	0.50	22.20
2013-14	2.20	0.10	0.70	22.00
2014-15	2.60	0.40	1.10	21.70
2015-16	3.10	0.00	1.50	23.70
2016-17	3.50	0.30	1.80	25.10
2017-18	2.40	0.10	0.70	25.10
2018-19	2.50	0.10	0.80	25.30
2019-20	2.60	0.60	0.90	26.30
2020-21 (RE)	4.70	2.00	2.70	31.10
2021-22 (BE)	3.70	0.50	1.70	31.20

Source: RBI Study of State Budgets, Various Years

#### 4.2. State-specific assessment for selected states

As mentioned above, for a more detailed analysis, three states have been selected: Karnataka, Haryana, and Tamil Nadu. Before delving into the impact estimation, this section outlines the social, economic, and fiscal status of these three states.

Table 7 shows GSDP growth for the three states in current and constant prices for pre-GST period and period thereafter. As it can be seen, all three states witnessed a growth deceleration in GSDP, in both current and constant terms, after GST was introduced in 2017. However, Tamil Nadu managed to maintain a stronger average growth rate compared to the other two states in the post-GST period from 2017-18 to 2020-21. It is also noteworthy to mention that even in the year 2020-21 with maximum COVID-19 related disruption in economic activity, Tamil Nadu reported positive real growth of 1.4 percent relative to contraction in Karnataka and Haryana at 2.6 percent and 5.7 percent respectively.

**Table 7: GSDP growth in current and constant prices, 2012-13 to 2020-21 (in percentages)**

	In Current Prices			In Constant Prices		
	Tamil Nadu	Haryana	Karnataka	Tamil Nadu	Haryana	Karnataka
<i>Pre-GST Period: Average of 2012-13 to 2016-17</i>	11.6	13.6	14.8	6.7	9.0	9.3
<i>GST Period: Average of 2017-18 to 2020-21</i>	10.0	8.2	8.4	5.8	3.9	4.4
2017-18	12.5	14.9	10.7	8.6	6.7	8.6
2018-19	11.3	9.3	11.5	7.0	6.1	6.5
2019-20	10.2	10.7	9.3	6.1	8.2	5.0
2020-21	5.9	-2.0	2.2	1.4	-5.7	-2.6

Source: MOSPI

All three states of Haryana, Karnataka and Tamil Nadu are among the top states in terms of per-capita income. Relative to All States and UT average, Karnataka and Haryana have higher development expenditure as defined by Reserve Bank of India. Tamil Nadu, on the other hand, has low development expenditure share in total expenditure at 55.4 percent (Table 8). Development expenditure as percent of total expenditure in Karnataka and Haryana is 73.8 percent and 68.7 respectively. A similar trend is observed in social sector expenditure.

Another barometer to assess state finances is the extent of committed expenditure. By definition, high committed expenditure leaves little flexibility in the hand of policy makers. Committed expenditure comprises of pensions, interest payments and administrative services (majorly comprising of salaries and allowances). Haryana and Tamil Nadu have a higher committed expenditure as percentage of total expenditure relative to All States and UT average.

**Table 8: Fiscal Indicators (2019-20)**

State	Development expenditure (as % of total)	Social sector expenditure (as % of total)	Committed Expenditure (as % of RE)
Karnataka	73.8	39.3	25.8
Haryana	68.7	41.3	35.4
Tamil Nadu	60.4	33.5	34.9
All States and UTs	66.5	40.4	32.2

Source: RBI State Finances: A Study of Budgets 2021-22

A review of key deficit indicators of states over the past few years shows that Haryana has regularly posted revenue deficit while Karnataka posted revenue surplus/balance in four out of the last six years. Tamil Nadu on the other hand, has also posted revenue deficit in the last few years albeit of a lesser magnitude relative to Haryana. High revenue deficit implies that the government is using borrowing to finance current expenditure (such as salaries, pension, interest payments or operational expenses).

**Table 9: Key Deficit Indicators of states, in percentage**

<i>Indicator</i>	<i>Year</i>	<i>Haryana</i>	<i>Karnataka</i>	<i>Tamil Nadu*</i>
<i>Revenue Deficit</i>	2016-17	2.9	-0.8	-4
	2017-18	1.6	-0.3	1.5
	2018-19	1.5	0	1.4
	2019-20	2.2	-0.1	2
	2020-21	2.1	1.07	3.5
	2021-22	1.4	0.36	2.8
	2022-23 BE	0.98	0.78	-
<i>Primary Deficit</i>	2016-17	2.8	2.5	-2
	2017-18	1.1	1.3	0.9
	2018-19	1.1	1.5	1.1
	2019-20	1.9	1.2	1.6
	2020-21	1	2.5	3.6
	2021-22 RE	0.82	1.26	2.8
	2022-23 BE	0.87	1.71	-
<i>Fiscal Deficit</i>	2016-17	4.7	4.3	-0.4
	2017-18	2.9	2.3	2.7
	2018-19	3	2.5	2.9
	2019-20	3.9	2.3	3.3
	2020-21	3.3	3.7	5.5
	2021-22 RE	2.99	2.8	3.8
	2022-23 BE	2.98	3.26	

Source: State finances- A Study of State Budgets, Various Years, Government Budget Documents, \*For Tamil Nadu, all indicators for 2020-21 is Revised Estimates and for 2021-22 fiscal deficit is revised estimates, primary deficit and revenue deficits are Budget Estimates.

Haryana has been proactive in bringing down the fiscal deficit over time except in 2020-21 when COVID-19 led to increased spending on health and livelihood. In 2021-22, as per the revised estimates, the fiscal deficit of Haryana was estimated at 2.99 percent of GSDP, showing a reduction of 0.31 percentage points from the previous year.

All three states have reported strong growth in own tax revenues at least till 2017-18. State's own tax revenue (SOTR) includes revenues earned through Sales Tax, State Excise duty, SGST, Land Revenue, Stamps & Registrations, and other state level taxes, but excludes all tax revenues devolved from the centre. While Haryana experienced significant deceleration of growth to 2.2 percent in own tax revenues in 2018-19, Karnataka and Tamil Nadu could manage to grow their own-tax revenues at 8 percent and 10 percent respectively in 2018-19. However, since then all three states have experienced decline in growth in own tax revenues (Table 10). The fall

in revenue shows the fiscal pressure on states, which is likely to have been further exacerbated by the additional expenditures on account of the Covid-19 pandemic.

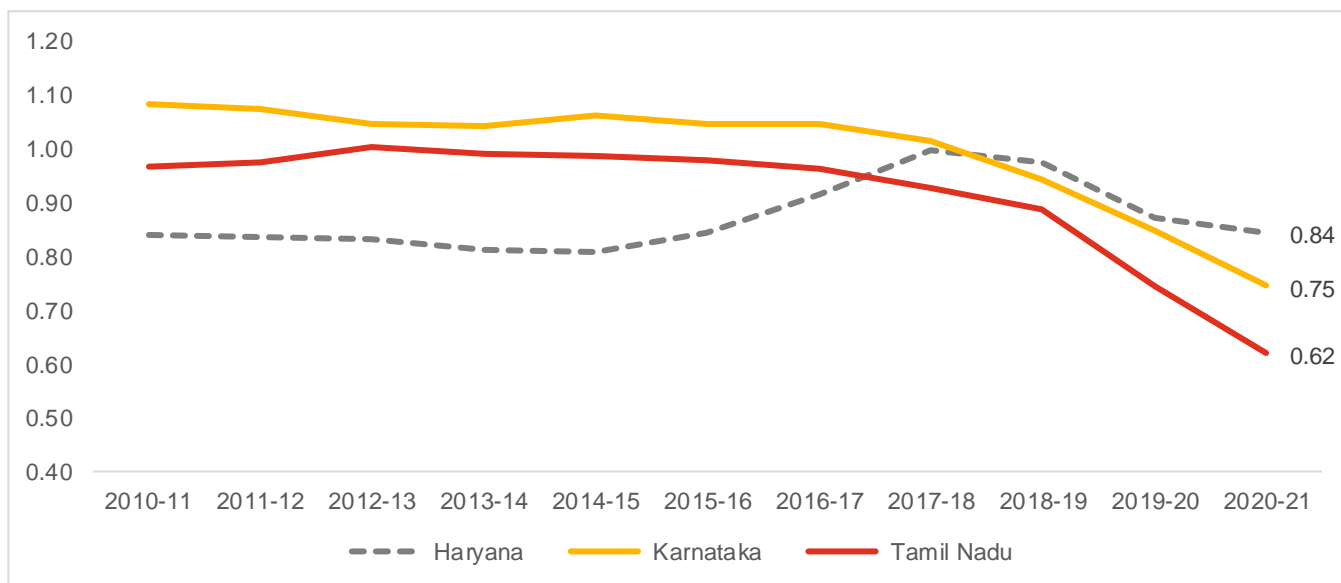
**Table 10: Annual Growth rate of State Own Tax Revenue, in percentage**

SOTR	Haryana	Karnataka	Tamil Nadu
2012-13	15.5%	15.7%	19.7%
2013-14	8.5%	16.5%	3.5%
2014-15	8.1%	12.1%	6.7%
2015-16	11.9%	7.7%	2.3%
2016-17	10.0%	9.8%	6.8%
2017-18	23.0%	8.9%	12.3%
2018-19	2.2%	8.0%	10.0%
2019-20	0.2%	4.9%	1.2%
2020-21	8.0%	-5.2%	-1.2%
2021-22 (RE)	40.5%	14.9%	14.8%

Source: RBI State Finances: A Study of Budgets 2021-22 and Government Budget Documents

State's Own Tax buoyancy, which shows percentage change in tax collections with one percent change in GSDP (or the tax base) has been measured for the three states. A tax buoyancy of one implies that with one percent increase in tax base (i.e., GDP in this case), the tax revenue increases by one percent, thus leaving the tax-to-GDP ratio unchanged. When the tax buoyancy exceeds one, the percent change in tax revenue is more than percent change in GDP in the given period. Table 10 shows tax buoyancy is on a decline since 2017-18 for all three states. The latest available data show some improvement in revenue collections in Haryana, but not in the other two states.

**Figure 11: Own Tax Buoyancy of SOTR to GSDP**



Source: RBI, MOSPI, Author's calculations

In 2017, the FRBM Review Committee<sup>23</sup> had recommended that a debt to GDP ratio of 60% should be targeted for the entire country, with a 40% limit for the centre and 20% limit for the states. Similarly, the Fourteenth Finance Commission (FC-XIV) had recommended a threshold of 25% for the state's debt-GDP ratio<sup>24</sup>. As of 2019-20, while Karnataka is below the 25% limit, Haryana and Tamil Nadu have exceeded it. (Table 11). The latest estimates (BE) for 2022-23 show that the debt-to-GDP ratio has increased for Karnataka to 22.18% and fallen for Haryana from 24.98% to 24.52%<sup>25</sup>. The ratio of interest payments to revenue receipts is at the lower end for Karnataka and relatively high for Haryana. Revenue receipts typically include the proceeds from taxes and other duties; the interest and dividend received on investments; and fees and charges for services. The usage of a high proportion of revenue receipts for debt servicing limits the availability of funds for development expenditure.

**Table 11: Debt and Interest Burden (2019-20)**

State	Debt to GSDP Ratio	Interest payment (Gross) to revenue receipts	Maturity Profile of Outstanding Securities (%) (As of end-March 2021)				
			0-1 year	1-3 years	3-5 years	5-7 years	Above 7 years
Karnataka	20.8%	10.56%	3.8	9.5	15.1	22.3	49.2
Haryana	28.1%	22.97%	5.2	19.1	19.8	18.8	37.1
Tamil Nadu	25.7%	18.32%	3.6	14.6	18.1	22.7	41.1
All States and UTs	26.3%	11.95%	5.3	13.4	17.1	20.0	44.2

Source: State Finances: A Study of Budgets 2021-22, RBI

With falling tax buoyancy and high debt obligations, the three states of Haryana, Karnataka and Tamil Nadu would need to strike a balance between their indebtedness and debt servicing commitments and the resource requirements to fulfil their development goals.

#### 4.3. Impact of withdrawal of GST compensation on states' finances

Considering the economic and fiscal context of all states as well as the analysis of three specific states, this section estimates the impact of the removal of GST compensation post June 2022 on state revenues.

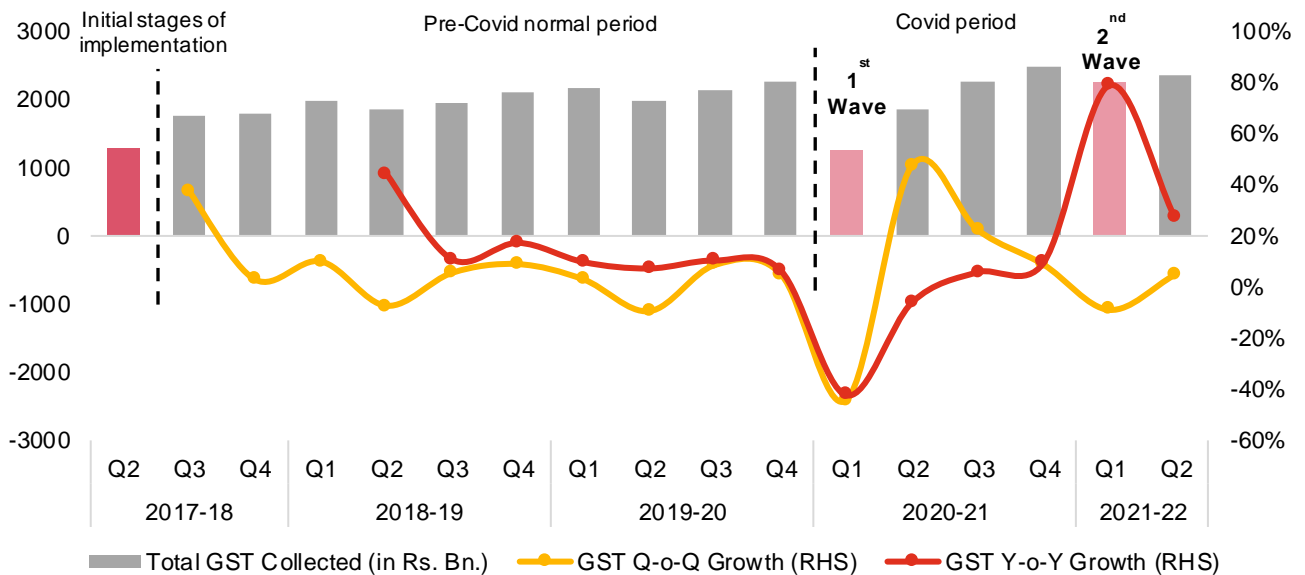
Figure 12 presents the quarterly GST collection in India since the implementation of the GST regime in July 2017. The entire GST period has been divided into three phases viz., (i) initial stages of implementation (Q2 2017-18), (ii) pre-covid normal period (Q3 2017-18 to Q4 2019-20) and (iii) covid period (Q1 2020-21 to Q2 2021-22). Due to seasonality in the GST collection trends, the growth rate of GST collection from one quarter to another, as well as a year-on-year growth rate (comparing one quarter of a year with the same quarter of the previous year) has been displayed in Figure 12.

<sup>23</sup> Responsible Growth (2017) FRBM Review Committee Report – Volume 1  
<https://dea.gov.in/sites/default/files/Volume%201%20FRBM%20Review%20Committee%20Report.pdf>

<sup>24</sup> Fourteenth Finance Commission Report  
[https://fincomindia.nic.in/writereaddata/html\\_en\\_files/oldcommission\\_html/fincom14/others/14thFCReport.pdf](https://fincomindia.nic.in/writereaddata/html_en_files/oldcommission_html/fincom14/others/14thFCReport.pdf)

<sup>25</sup> Budget estimates for 2022-23 for Tamil Nadu are not available as of the time of writing this report.  
 Reference for Haryana: <http://web1.hry.nic.in/budget/Bgfinal.pdf>

**Figure 12: Trend in GST collection and growth rates at all India level**



Source: GST Statistics (<https://www.gst.gov.in>)

Note: Total GST Collection includes CGST, SGST and IGST. This excludes GST Compensation Cess and IGST on imports.

In the initial phase of implementation (Q2 2017-18), collections on GST remained limited to nearly INR 1.2 trillion (~ GBP 12 billion). Post this, the country moved to a phase of normalcy, Q3 2017-18 to Q4 2019-20 before the economy was hit by COVID-19. Average Y-o-Y growth rate of GST collections during the pre-Covid period was around 7.7 percent. However, during the Covid period, economic activity was disrupted, and GST collections declined by 21.6 percent in Q1 2020-21 relative to Q1 of the previous year. In Q1 2021-22, as the economy experienced a second wave, while GST collections declined relative to the previous quarter. However, in comparison to the low base of Q1 of the previous year (2020-21), the economy still experienced strong Y-o-Y growth in Q1 2021-22 in GST collections.

To estimate the potential impact of removal of GST compensation on state finances, the following steps were taken:

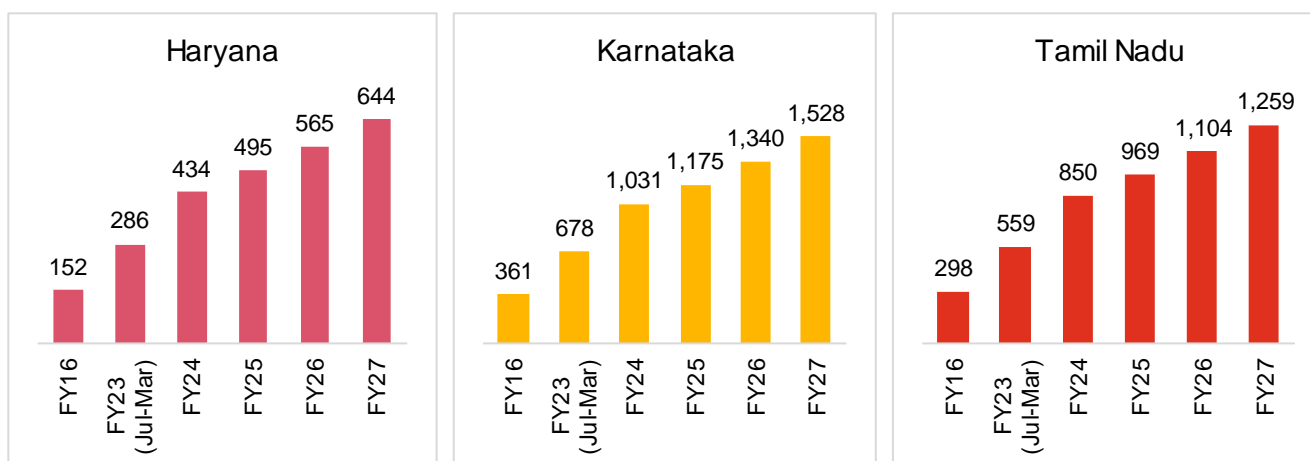
### Step 1: Estimating Revenue Under Protection (RUP)

The Goods and Services Tax (Compensation to States) Act 2017 states that the Revenue Under Protection (RUP) for any year in a State shall be calculated by applying a fixed growth rate of 14% over the base year's revenue of that State, where the base year is 2015-16 and revenue includes revenue collected from all taxes subsumed into GST. For instance, if the base year revenue for 2015-16 for a concerned State is one hundred rupees, then the projected revenue for 2018-19 shall be as follows:

$$RUP \text{ for } 2018 - 19 = 100 * \left(1 + \frac{14}{100}\right)^3$$

Based on this approach, the RUP for select states has been estimated for the period 2022-23 (Jul – Mar) to 2026-27 (Figure 13).

**Figure 13: Estimated Revenue Under Protection for select states (in INR Bn.)**



Source: Mukherjee, S. (2020). Possible impact of withdrawal of GST compensation post GST compensation period on Indian state finances (No. 20/291)

## Step 2: Estimating tax buoyancy of revenue collected under GST regime

Tax buoyancy is the measure of the responsiveness of tax collection to changes in tax base (gross domestic product in this case) of the economy. In discrete terms, it is defined as the percentage change in tax collection over a specific period as a ratio of the percentage change in the tax base<sup>26</sup>. When buoyancy is estimated over a longer period of several years, it is usually done by double-log regression with tax collection as the dependent variable and the tax base (GDP in most cases) as the independent; the coefficient of GDP directly provides the buoyancy estimate. Here, the buoyancy of GST has been estimated for the entire GST period (Q3 2017-18 to Q2 2021-22). Table 12 presents estimates of GST buoyancy on a ten-period rolling basis.

**Table 12: Estimates of buoyancy of GST with respect to GDP**

Period	Buoyancy
2017-18 Q3 – 2019-20 Q3	1.28
2017-18 Q4 – 2019-20 Q4	1.37
2018-19 Q1 – 2020-21 Q1	1.95
2018-19 Q2 – 2020-21 Q2	1.95
2018-19 Q3 – 2020-21 Q3	1.85
2018-19 Q4 – 2020-21 Q4	1.70
2019-20 Q1 – 2021-22 Q1	1.71
2019-20 Q2 – 2021-22 Q2	1.67

Based on the buoyancies estimated in Table 12, three scenarios of GST buoyancy at All-India level were constructed: minimum buoyancy (1.28), average buoyancy (1.69) and maximum buoyancy (1.95), experienced during the GST period (Q3 2017-18 to Q2 2021-22). It may be noted that as the buoyancy rises, the projected revenue would be progressively higher; given the unchanging estimates of RUP, this would imply progressively lower revenue shortfalls to contend with. A sufficiently high buoyancy may even eliminate revenue shortfall. Further, the speed of the process of eliminating the shortfall in revenue would also be determined by the buoyancy, i.e., with a higher buoyancy, the estimated revenue shortfall will be mitigated in a fewer number of years post the removal of the compensation. The estimates provide some empirical content for this a priori

<sup>26</sup> To illustrate, if GDP increases over a year by 10% and tax collection by 11%, then buoyancy would be  $(11/10 = 1.1)$

observation to indicate the extent of increase in buoyancy needed to limit the GST-related revenue shortfall in the three selected states. The intent is to provide some idea of the difficulty the three states would face to manage the loss of revenue after June 2022.

Scenario	Buoyancy	Value
Scenario 1	Minimum Buoyancy	1.28
Scenario 2	Average Buoyancy	1.69
Scenario 3	Maximum Buoyancy	1.95

Under normal circumstances, a tax buoyancy of 1.28 is considered to be 'high'. Owing to the abnormal impact of the pandemic coupled with low GST collections at the initial stage, a comparatively high value of minimum, average, and maximum buoyancy were estimated in the scenarios mentioned above. Such buoyancy values are not usually obtained in the absence of significant events that impact the economy. Thus, for the purpose of analysis, GST collections in the subsequent sections have been forecasted using Scenario 1 that estimated the minimum buoyancy in the GST period. Please refer to Appendix E for GST forecasts in the three different buoyancy scenarios.

### Step 3: Forecasting GST collections at India level using buoyancy 1.28

In this step, GST collections are forecasted for the period of 2021-22 to 2026-27 at an all-India level under Scenario 1 (Refer Appendix E for GST forecasts under all 3 scenarios). Data on growth rate of nominal GDP is available for the period 2017-18 to 2021-22, while the estimates for 2022-23 to 2026-27 are obtained from IMF's World Economic Outlook Oct 2021. Once the growth rate of nominal GDP is available, the growth rate in GST can be estimated using the buoyancy estimates.

**Table 13: Forecasted GST collections using minimum tax buoyancy**

FY	Nominal GDP <sup>27</sup> (In INR Tn.)	Nominal GDP Growth	Estimated Growth in GST	GST Forecast (In INR Bn.)
<b>Buoyancy = 1.28</b>				
2017-18	170.90			
2018-19	188.87	10.5%		
2019-20	200.75	6.3%		
2020-21	198.01	-1.4%		
2021-22	236.44	19.4%		10167
<b>Forecasted period</b>				
2022-23	269.96	14.2%	18.1%	12005
2023-24	301.18	11.6%	14.7%	13775
2024-25	335.04	11.2%	14.3%	15750
2025-26	372.34	11.1%	14.2%	17986
2026-27	413.53	11.1%	14.1%	20523

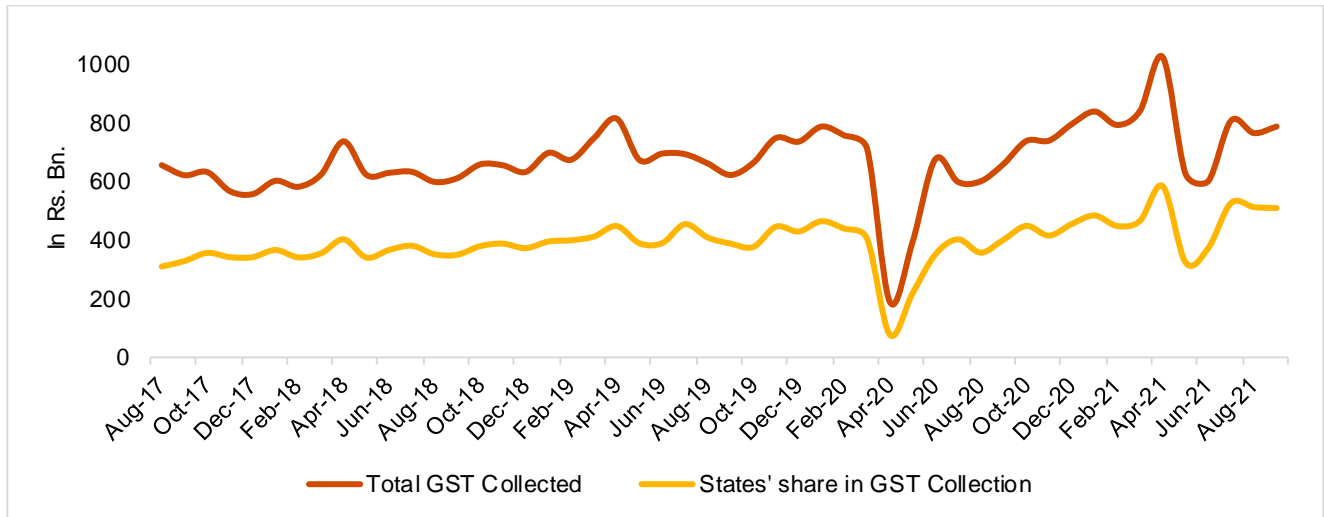
### Step 4: Forecasting GST collections for select states

#### Estimating the share of states/UTs in total GST collection

<sup>27</sup> Note: For nominal GDP of 2017-18 third revised estimates have been used. For 2018-19 and 2019-20, second revised estimates have been used. For 2020-21 and 2021-22 first revised estimates and second advance estimates have been used. For 2018-19, third revised estimate is available but not quarter wise hence, second revised estimates has been used.

Essentially, the forecasted GST collections of the three selected states are derived from the estimates of total GST collections using relevant proportions. This is based on the observation that the proportions are fairly stable. This can be seen from the trends in GST collections overall, at the state level, and in the selected states. Figure 14 presents the relationship between GST collected at the state/UT level and total GST collection in India.

**Figure 14: Trend in GST collection at State/UT level vis-à-vis total GST collection**



Source: GST Statistics (<https://www.gst.gov.in>)

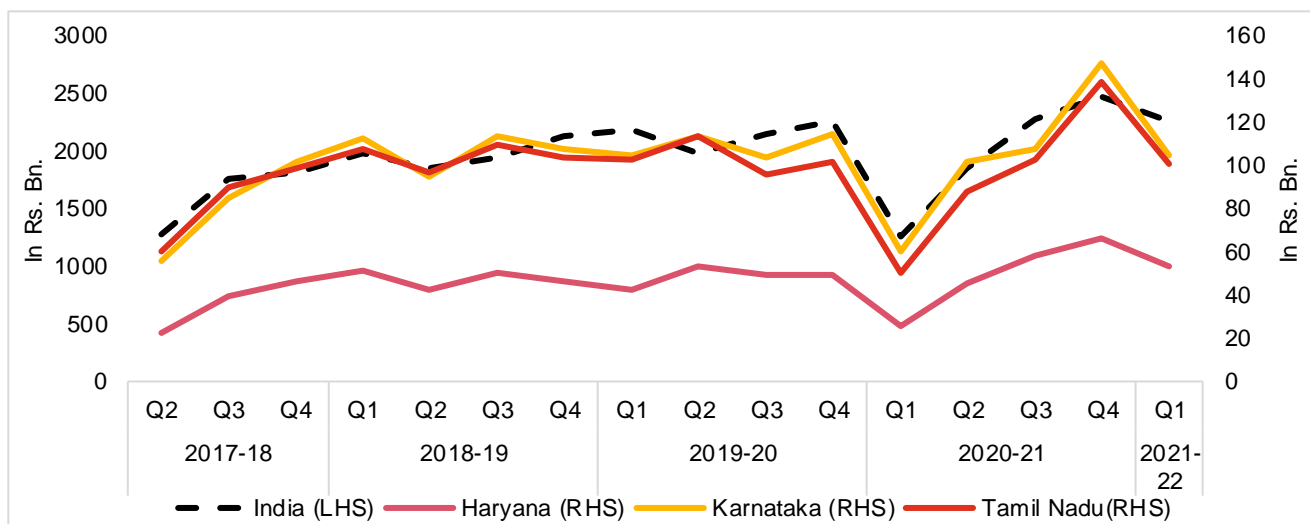
Note: Total GST Collection includes CGST, SGST and IGST. This excludes GST Compensation Cess and IGST on imports. For GST collected at state level, only SGST and IGST Settlement has been considered.

It can be observed that States'/UTs' GST collection mimics total GST collections at all India level. For the period of August 2017 to September 2021, the correlation between the total GST collection (excluding the Compensation Cess and IGST on imports) and the revenue earned by States and UTs together (which includes SGST and IGST settlement) stands at around 0.94. During the same period, the share of states/UTs in total GST collection averaged at 58%.

**Estimating share of select states in States'/UTs' GST collection**

Figure 15 presents the relationship between GST collected by Haryana, Karnataka and Tamil Nadu and total GST collection in India. As in the case of overall States'/UTs' GST collection, GST collection for the select states also exhibit similar trend as that of total GST collection.

**Figure 15: Trend in GST collection for select states vis-à-vis total GST collection**



Source: GST database (<https://www.gst.gov.in/>)

Note: Total GST Collection includes CGST, SGST and IGST. This excludes GST Compensation Cess and IGST on imports. For GST collected at state level, only SGST and IGST Settlement has been considered.

For the period of August 2017 to June 2021, the share of select states in the total GST collected at the State/UT level is provided below.

**Table 14: Average share of states in total GST collection, in percentage**

State	Share in States'/UTs' GST collection
Haryana	3.8
Karnataka	8.4
Tamil Nadu	8.0

Source: GST database (<https://www.gst.gov.in/>)

Note: Total GST Collection includes CGST, SGST and IGST. This excludes GST Compensation Cess and IGST on imports. For GST collected at state level, only SGST and IGST Settlement has been considered.

### Forecasting GST collection for select states for the period 2021-22 to 2026-27

Using the projected share of States/UTs in total GST collection and the share of select states in States'/UTs' GST collection, the GST collection for the three states can be forecasted using Table 14. The results of this analysis are presented in Table 14.

**Table 15: Forecasted GST collections (in billion INR)**

FY	GST Forecast	States'/UTs' share	Haryana	Karnataka	Tamil Nadu
<b>Buoyancy: 1.28</b>					
2021 - 22	10167	5897	224	496	474
2022 - 23	12005	6963	264	586	560
2023 - 24	13775	7990	303	672	643
2024 - 25	15750	9135	347	768	735
2025 - 26	17986	10432	396	877	839

FY	GST Forecast	States'/UTs' share	Haryana	Karnataka	Tamil Nadu
2026 - 27	20523	11904	452	1001	958

Source: Source: GST Statistics (<https://www.gst.gov.in>) and PwC calculations

Note: GST collection excludes GST Compensation Cess and IGST on imports and State's share includes SGST and IGST Settlement

### Step 5: Adjustment for 2022-23

Since the compensation will cease post June 2022, the GST forecasts for 2022-23 need to be adjusted for the remaining nine months (Q2 to Q4) of collection. Thus, based on past trends of quarterly collections of GST revenue, the revenue for 2022-23 is adjusted for the nine months when GST compensation will be discontinued (Table 16).

**Table 16: Average split of GST collections at state levels across quarters in 2018-19 and 2019-20**

Quarter	Haryana	Karnataka	Tamil Nadu
Q1	24.5%	25.2%	25.3%
Q2	24.8%	24.1%	25.3%
Q3	25.8%	25.1%	24.6%
Q4	24.9%	25.7%	24.8%
<b>Q2 - Q4</b>	<b>75.5%</b>	<b>74.8%</b>	<b>74.7%</b>

Source: Source: GST Statistics (<https://www.gst.gov.in>) and PwC calculations

Note: For GST collected at state level, only SGST and IGST Settlement has been considered.

### Step 6: Estimating revenue shortfall

Having forecasted the state-wise RUP for FY 2022-23 (Jul – Mar) to FY 2026-27 as well as projected GST collection for this period for scenario 1, the revenue shortfall that the select states may face post withdrawal of GST compensation can be estimated as the difference between the two.

#### Revenue Gap for Haryana

**Table 17: Revenue Gap for Haryana as percentage of RUP, SOTR and TR<sup>28</sup>**

Year	Gap (% of RUP)	Gap (% of SOTR)	Gap (% of TR)
	At Tax Buoyancy of 1.28		
2022-23 (Jul-Mar)	30.17%	19.86%	11.82%
2023-24	30.20%	20.71%	12.16%
2024-25	29.99%	21.42%	12.42%
2025-26	29.87%	22.22%	12.71%
2026-27	29.81%	23.10%	13.04%

Source: PwC Calculations, Note: SOTR: State's Own Tax Revenue; TR: Total Revenue

<sup>28</sup> India has a federal structure in which there are constitutional provisions whereby certain taxes are levied and collected by the states themselves. These taxes are termed as state's own tax revenue (SOTR). Total Revenue includes both state-own tax revenue, share in central taxes, grants received from center, non-tax revenues.

### Revenue Gap for Karnataka

**Table 18: Revenue Gap for Karnataka as percentage of RUP, SOTR and TR**

Year	Gap (% of RUP)	Gap (% of SOTR)	Gap (% of TR)
	At Tax Buoyancy of 1.28		
2022-23 (Jul-Mar)	35.38%	26.61%	16.73%
2023-24	34.83%	27.58%	16.91%
2024-25	34.63%	28.99%	17.27%
2025-26	34.52%	30.55%	17.67%
2026-27	34.46%	32.23%	18.11%

Source: PwC Calculations, Note: SOTR: State's Own Tax Revenue; TR: Total Revenue

### Revenue Gap for Tamil Nadu

**Table 19: Revenue Gap for Tamil Nadu as percentage of RUP, SOTR and TR**

FY	Gap (% of RUP)	Gap (% of SOTR)	Gap (% of TR)
	At Tax Buoyancy of 1.28		
2022-23 (Jul-Mar)	25.16%	13.90%	8.61%
2023-24	24.34%	14.29%	8.83%
2024-25	24.11%	15.15%	9.28%
2025-26	23.99%	16.13%	9.79%
2026-27	23.92%	17.21%	10.34%

Source: PwC Calculations, Note: SOTR: State's Own Tax Revenue; TR: Total Revenue

Estimation of revenue shortfall leads us to the following key insights:

- Tamil Nadu (Table 19) reports lowest revenue shortfall after discontinuation of GST compensation relative to other two states, Haryana, and Karnataka. In terms of State's own tax revenues (SOTR), revenue shortfall in 2022-23 (Jul-Mar) would be 13.9 percent as compared to 26.6 percent for Karnataka (Table 18) and nearly 20 percent for Haryana (Table 17). This is despite a steep fall in tax buoyancy in Tamil Nadu. The key reason for the relatively low revenue impact on Tamil Nadu is that at the time of the GST launch, while type of taxes subsumed under GST across states was the same but their importance in respective states' own-tax revenues was different. For example, in Tamil Nadu, subsumed taxes in GST were 37 percent of state own-tax revenues while in case of Karnataka and Haryana it was substantially lower at 47.8 percent and 49.2 percent respectively. This can be attributed to substantially higher share of tax collection from taxes not subsumed under GST (such as tax on liquor) in Tamil Nadu. There is a state-wise variation in terms of revenue significance of different taxes and how they are subsumed. This percentage depends on the relative revenue dependence of different states on the different tax handles available to them; in a large country like India, this pattern is expected to and in fact does vary across states considerably.
- However, the results of exercise show that with the buoyancy assumed at 1.28, none of the three states, including Tamil Nadu, is able to reduce the shortfall (as a percentage of RUP) except marginally even by 2026-27. It would appear that while all three states would need to undertake measures to raise their buoyancy to avoid a major shock to their revenue flows, among the three states, Karnataka is likely to face the most difficult adjustments to make up for the revenue loss, while Tamil Nadu would have relatively less difficulty.

But such a conclusion would not be entirely warranted because the adjustments needed must be undertaken in the context of a broader fiscal scenario of each of the states that varies substantially between them. Among the three states, Karnataka has relatively fewer fiscal problems and Haryana had the most. Karnataka is one of the leading states in terms of development spending as percent of total expenditure. Sound public finances in terms of slightly higher fiscal deficit but with low public debt and committed expenditure provides some comfort. On the other hand, Haryana's fiscal deficit in 2022-23 is budgeted to be 2.99 percent (just at 3 percent limit), with high debt at 24.5 percent in 2022-23, committed expenditure is at 35 percent of total expenditure as per latest estimates (2019-20), development spending as percent of total expenditure is on a lower side and the State's SDG index score is also lower than All-India average. The revenue shortfall discussed here comes on top of existing fiscal issues needing correction, and from that perspective, Haryana appears to need the maximum adjustment.

- As noted in the previous sections, Tamil Nadu has relatively poor fiscal indicators (higher fiscal deficit, low development spending, high committed expenditure). While Tamil Nadu has relatively lower impact of GST compensation discontinuation post June 2022, there is significant scope for improving tax buoyancy in Tamil Nadu. For the period 2011-12 to 2020-21, the own-tax revenue buoyancy with respect to GSDP for Tamil Nadu was only 0.62. This is also true in case of SGST and IGST settlement. For the period 2017-18 Q3 to 2021-22 Q1, average quarterly growth in SGST and IGST settlement together is 7.7 percent which is 10.7 percent for Haryana and 8.3 percent for Karnataka. GSDP growth in Tamil Nadu has been robust during the GST period as shown in Table 8. This shows that in case of Tamil Nadu the tax base has been growing but this is not reflecting in GST collections. This calls for identification of areas for improvement in GST administration in Tamil Nadu. Ultimately, each of the three states need to undertake substantive measures to tackle the reduced revenue flow starting from July 2022. Detailed tax forecasts in different buoyancy scenarios have been provided in Appendix E.
- Annual GST data and GSDP data are available only for four years 2017-18, 2018-19, 2019-20, and 2020-21. There are no estimates for quarterly GSDP at the state level. Therefore, state-specific GST buoyancy comparable to those estimated for the overall GST collections cannot be estimated. However, the estimated shortfalls under alternative buoyancy assumptions show that at a buoyancy of 1.28, the gap relative to RUP only goes up. Efforts would be needed to increase buoyancy (perhaps up to 1.69) so that the gap with RUP shrinks over time.

### **Box 2: 15<sup>th</sup> Finance Commission incentives towards efficient tax administration**

The 15th Finance Commission (XVFC) has used performance incentives to motivate the states with more funds for better population control and better tax performance. In doing so, it has aimed to balance the principles of expenditure needs, equity and efficiency. This is not a new approach; several commissions in the past have used performance as a criteria for devolution of taxes and allocation of grants. However, as compared to in the past, a relatively small weight of 2.5% has been allotted to tax and fiscal efforts, which is meant to reward states that have managed to increase tax collections in a more efficient manner thereby raising their tax earnings. The XVFC has calculated a state's tax performance by considering the ratio of its average per capita tax revenue over three years, and its per capita Gross State Domestic Product over a similar period.

While an argument might be made in favour of increasing the weight of 2.5% to place greater importance on increasing tax revenue, the Finance Commission will need to keep in mind the fact that the simple tax ratio may not accurately represent tax effort; a relatively low tax ratio could be a result of various limiting geographical, historical and socio-economic factors. Thus, other mediums of incentivizing states for higher tax collections might need to be assessed as well.

#### 4.4. Impact on development spending

Development expenditure of states consists of two major heads – social services and economic services. As per the average development expenditure from the state accounts over the decade from 2010-11 to 2019-20, the composition of development expenditure is shown in Table 20.

**Table 20: Composition of Development Expenditure (2019-20, INR Crore)**

Categories	All States	Haryana	Karnataka	Tamil Nadu
<b>Total Development Expenditure</b>	<b>2,163,341</b>	<b>71,286</b>	<b>157,824</b>	<b>145,105</b>
Education, Sports, Art, and Culture	529,734	14,868	27,721	38,887
Medical and Public Health	150,709	4,760	8,344	9,340
Transport	165,572	4,898	12,464	11,660
Energy	209,881	13,006	15,623	10,745
Agriculture and Allied Activities	211,993	7,942	21,993	15,491
Major and Medium Irrigation and Flood Control	113,169	2,893	15,446	4,524
Rural Development	169,328	3,985	7,341	5,367
Urban Development	89,877	4,185	3,938	4,488
Social Security and Welfare	131,339	7,641	10,026	8,317
Industry and Minerals	30,674	405	1,924	4,088
Family Welfare	27,081	223	816	2,981
Water Supply and Sanitation	63,835	2,981	4,618	2,064
Welfare of Scheduled Castes, Scheduled Tribes, and Other Backward Classes	93,588	290	9,951	4,486
General Economic Service	35,250	343	4,426	10,802
Science, Technology and Environment	1,575	36	66	29
Housing	30,943	134	3,447	3,198
Others	108,792	2,695	9,681	8,638
<b>Distribution (as % of total development expenditure)</b>				
Education, Sports, Art, and Culture	24.49	20.86	17.56	26.80
Agriculture and Allied Activities	9.80	11.14	13.94	10.68
Energy	9.70	18.24	9.90	7.40
Rural Development	7.83	5.59	4.65	3.70
Transport	7.65	6.87	7.90	8.04
Medical and Public Health	6.97	6.68	5.29	6.44
Social Security and Welfare	6.07	10.72	6.35	5.73
Major and Medium Irrigation and Flood Control	5.23	4.06	9.79	3.12
Welfare of Scheduled Castes, Scheduled Tribes, and Other Backward Classes	4.33	0.41	6.30	3.09
Urban Development	4.15	5.87	2.50	3.09
Water Supply and Sanitation	2.95	4.18	2.93	1.42
General Economic Service	1.63	0.48	2.80	7.44
Housing	1.43	0.19	2.18	2.20
Industries and Minerals	1.42	0.57	1.22	2.82
Family Welfare	1.25	0.31	0.52	2.05
Science, Technology and Environment	0.07	0.05	0.04	0.02
Others	5.03	3.78	6.13	5.95

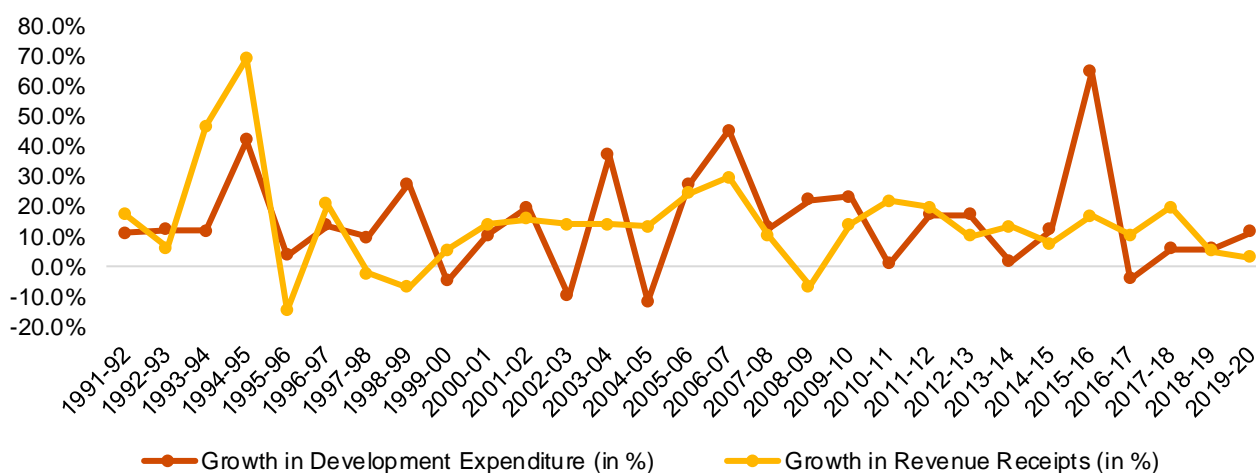
Source: RBI Study of State Budgets, 2021-22

Considering all the components together, the three states of Haryana, Karnataka and Tamil Nadu spend the largest share of development spending on education, sport, art, and culture - 20.9%, 17.6%, and 26.8% respectively. For the state of Haryana, energy was on the forefront after education with over 18% of development spending. This was followed by expenditure on Agriculture and Allied Activities and social security and welfare with a share of 11.1 % and 10.7% respectively. In Karnataka, agriculture and allied activities was a sector of focus accounting for 13.9% of development spending. This was followed by expenditure in the energy sector (9.9%), and irrigation and flood control (9.7%). In Tamil Nadu, the focus area in terms of spending was the agriculture, and allied activity sector accounting for 10.7% of development spending. This was followed by spending on transport for 8%.

Development spending has been most influenced by the resources available to the state governments. Growth in revenues is essential for sustaining development expenditure – whether it is rising at the appropriate rate to achieve certain critical targets. Therefore, the effect of revenue receipts on development expenditure can be seen only in terms of growth.

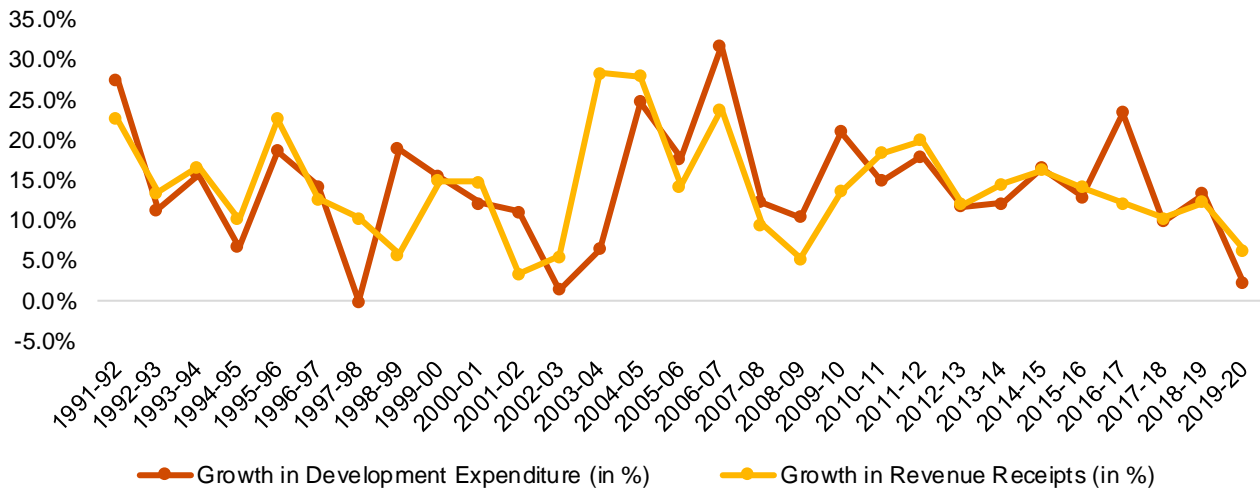
When states expect acceleration in growth in revenue collections, generally the development expenditure growth is also enhanced and vice-versa. This is further shown in Figure 16, Figure 17, and Figure 18 for each of the three states.

**Figure 16: Trend in growth of Development Expenditure and Revenue Receipts (Haryana)**



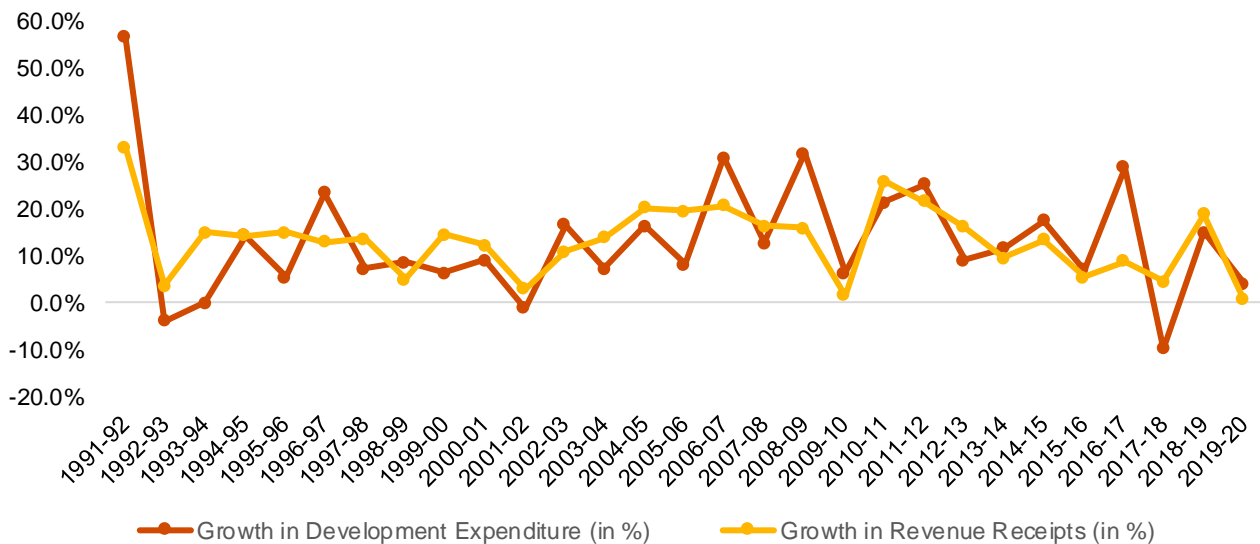
Source: RBI A Study of State Budgets, Various years

**Figure 17: Trend in growth of Development Expenditure and Revenue Receipts (Karnataka)**



Source: RBI A Study of State Budgets, Various years

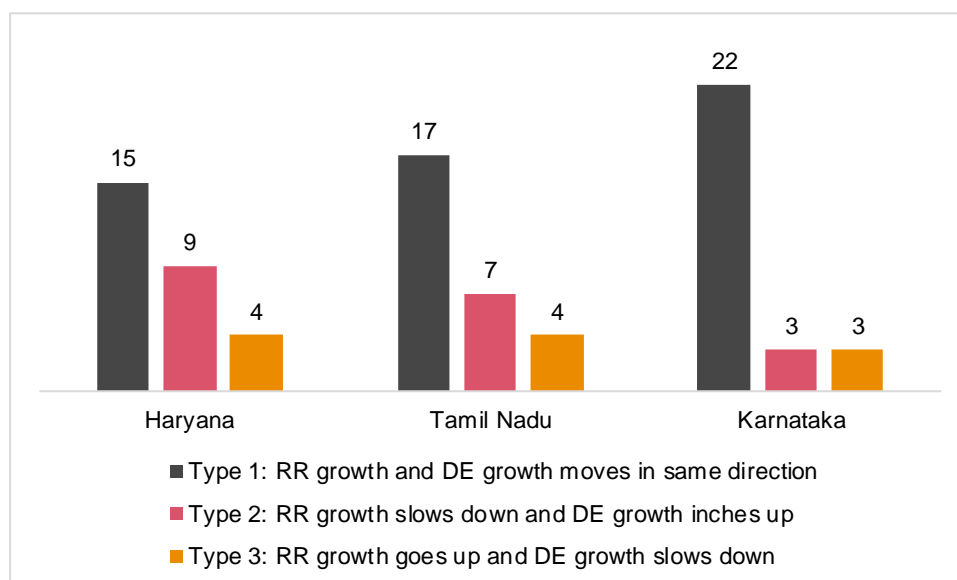
**Figure 18: Trend in growth of Development Expenditure and Revenue Receipts (Tamil Nadu)**



Source: RBI A Study of State Budgets, Various years

Furthermore, Figure 19 shows three types of growth trends in development expenditure and revenue receipts. Under Type 1, we count number of years in which acceleration in growth in revenue receipts from the preceding year is accompanied by acceleration in growth in development expenditure from the preceding year and vice-versa. Type 2 counts number of years when despite deceleration in growth in revenue receipts, development expenditure growth accelerates. Type 3 counts number of years when despite acceleration in growth in revenue receipts, development expenditure growth decelerates. Fiscal data for the last 28 years, 1992-93 to 2019-20, is analyzed.

**Figure 19: Revenue Receipt and Development expenditure growth (1992-93 to 2019-20, No. of times)**



Source: RBI A Study of State Budgets, Various years

It is clear from Figure 19, revenue receipts growth and development expenditure growth exhibit a strong positive correlation. In other words, a change in revenue receipts also carries a change in development expenditure in the same direction. The correlation coefficient between the two variables shows a strong tendency of the variables to move together as shown in Table 21. The correlation coefficient between the growth variables for the given period elicited a value of 0.32 for Haryana, 0.539 for Karnataka, and 0.696 for Tamil Nadu. This shows that a growth in revenue receipts and a growth in total expenditure moves together.

**Table 21: Correlation Coefficient between DE and RR, 1992-93 to 2019-20**

State	Correlation Coefficient	
	Development Expenditure and Revenue Receipts	Growth in Development Expenditure and Growth in Revenue Receipts
Haryana	0.989	0.32
Karnataka	0.998	0.539
Tamil Nadu	0.995	0.696

Source: RBI A Study of State Budgets, Various years

Curtailing development expenditure or slowing down the momentum is not desirable. It creates a disruption in various activities and the potential benefits of past spending. There is some evidence to it in Type-2 growth trends where despite a slowdown in revenue receipt growth, development expenditure carries forward the past momentum.

**Review of literature:**

There have been numerous studies on the role of government spending in the long-term growth of national economies (Aschauer 1989; Barro 1990; Tanzi and Zee 1997). These studies have investigated the effects of government spending on economic growth. However, there are not many empirical studies that establish a linkage between increased development expenditure and tax revenue. Much of the research done to date looks

either at discrete country examples, and/or narrowly at individual sectors like health (Xu, K., Saksena P. 2011<sup>29</sup>; Tamarappoo, et. al, 2016<sup>30</sup>) and education (UNICEF, 2017<sup>31</sup>). While there is a general recognition that increased tax base and revenues facilitate the provision of funds for developmental services, the lack of empirical research work at country level warrants an examination and quantification of the relationship.

The relationship between government revenue and government expenditure has conflicting evidence. Chang and Chiang (2009<sup>32</sup>) had analyzed the relation between government revenue and government expenditure for 15 OECD countries over the period 1992-2006. By using a panel causality Granger test, they concluded that the relation between the two variables was bidirectional. The theory of a causal link between government revenue and expenditure has resulted in several hypotheses. First, the tax-and-spend hypothesis advanced by Friedman (1978<sup>33</sup>) contends that changes in government revenue lead to changes in government expenditure. However, Friedman also inferred that tax increases will only lead to expenditure increases but result in an inability to reduce budget deficits. Empirically, this hypothesis is characterized by unidirectional causality running from government revenues to government expenditures.

Peacock and Wiseman (1961<sup>34</sup>) advocated the spend-and-tax hypothesis, wherein the temporary increases in government expenditures due to economic and political crises can lead to permanent increases in government revenues from taxation. They referred to it as the “displacement effect.” Contrary to the tax-and-spend hypothesis, this hypothesis is characterized by unidirectional causality running from government expenditures to revenue. The fiscal synchronization hypothesis proposed by Musgrave (1966<sup>35</sup>) argues that revenue and expenditure decisions are made jointly. The results from these empirical studies and hypothesis proposed are sensitive to the sample period under examination, the degree of temporal aggregation, the inclusion of macroeconomic controls, and the choice of econometric methodology.

An IMF study of poverty-reducing public spending for countries that reached Heavily Indebted Poor Countries (HIPC) point, assessed whether extra funds freed through debt relief were directed towards poverty-reducing spending<sup>36</sup>. This analysis, covering 35 countries, indicated that participating countries increased their poverty-reducing expenditure by an average of 2.5 percentage points of GDP over the period 2001 to 2013. As most of these countries were experiencing strong GDP growth over this period, countries experienced an average increase of 12 percent in poverty-reducing public spending in absolute terms each year over the period.

Fans and Saurkar (2008)<sup>37</sup> studied the size, trends, causes and the composition of government expenditure, with specific focus on six sectors - agriculture, defense, education, health, social security, and transportation and communication. The study used panel data – data across countries and years - from 1980 to 2002 for 44 countries spread across Asia, Africa and Latin America. According to the study, the major factors influencing total government expenditure as a percentage of GDP are government revenue as a percentage of GDP, aid received as a percentage of GDP, macro adjustment (dummy/indicator variable) and other factors affecting government expenditure. Some other relevant studies with the results are discussed in Appendix E.

With limited revenue generating capacities as estimated in Section 4.3, it is expected that states will have to cut down on their expenditures to maintain a comfortable fiscal deficit. A review of studies suggests that during periods of resource crunch, governments find it difficult to cut down on committed expenditures like salaries,

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<sup>29</sup> Ke, X. U., Saksena, P., & Holly, A. (2011). The determinants of health expenditure: a country-level panel data analysis. Geneva: World Health Organization, 26(1-28).

<sup>30</sup> Tamarappoo, R., Pokhrel, P., Raman, M., Francy, J., & Niño-Zarazúa, M. (2016). Analysis of the linkage between domestic revenue mobilization and social analysis of the linkage between domestic revenue mobilization and social sector spending. *Journal of International Development*, 3, 367-398.

<sup>31</sup> United Nations Educational, Scientific, and Cultural Organization, Paris (France). (2007). *Education for All by 2015: Will We Make It?*. ERIC Clearinghouse.

<sup>32</sup> Chang, T., & Chiang, G. (2009). Revisiting the government revenue-expenditure nexus: Evidence from 15 OECD countries based on the panel data approach. *Czech Journal of Economics and Finance (Finance a uver)*, 59(2), 165-172.

<sup>33</sup> Friedman M (1978): The limitations of tax limitation. *Policy Review*, 7–14

<sup>34</sup> Peacock, A. T., & Wiseman, J. (1961). Front matter, the growth of public expenditure in the United Kingdom. In *The growth of public expenditure in the United Kingdom* (pp. 32-0). Princeton University Press.

<sup>35</sup> Musgrave R (1966): Principles of budget determination. In: Cameron H, Henderson W (Eds.): *Public Finance: Selected Readings*. Random House, New York.

<sup>36</sup> Source: <https://www.imf.org/external/np/hipc/2001/tracktrack.pdf>

<sup>37</sup> Fan, S., Yu, B., & Saurkar, A. (2008). Public spending in developing countries: trends, determination, and impact. *Public expenditures, growth, and poverty*, 20-55.

wages, interest costs and pension payments and usually resort to cutting down development expenditure. This part of the report focuses on assessing the impact on development expenditure as revenues are adversely impacted post the end of the compensation period.

### Estimation and Model Building

As per the methodology discussed in Section 2.2, we used a panel regression model covering 25 states and nine years (between 2008-09 and 2016-17) to assess the impact of revenue shortfalls on the development expenditure of the state<sup>38</sup>. The choice of states and year was governed by data availability. We used a least squares dummy variable (LSDV) model with the dependent variable being development expenditure as a proportion of total expenditure of the state, as shown in Equation 1. The variables used in the model are specified in Table 1. Our primary variable of interest is revenue receipts and we have used several other control variables in this parsimonious specification. The model used robust standard errors to get unbiased standard errors so that the result is statistically valid and not influenced by the heterogenous nature of the state – large state, small state, etc.

### Equation 1: The specification

$$\left(\frac{de}{te}\right)_t = \alpha + \beta_1 \log(rev\_rec)_t + \beta_2 \log(pci)_t + \beta_3 fd_t + \beta_4 infra\_index_t + \beta_5 edu\_index_t + \sum_{i=6, j=1} \beta_i s_j + \varepsilon_t$$

Most of the coefficients of the independent variables used in the model are statistically significant. This is shown in Annexure F. **Statistical significance suggests a non-trivial or non-zero relationship between the independent and dependent variable.** A Type-I error occurs when we reject a hypothesis when it is true. The probability of committing this type of error is known as statistical significance (or alpha). Usually, a statistical significance value less than 5% or in some cases 10% is set as acceptable level. It means that out of 100 cases, maybe in 5% or 10% cases, the relationship between dependent and independent variable is zero i.e., the null hypothesis is true.

At the beginning, we hypothesized that there should be a positive relationship between revenue receipts and development expenditure to total expenditure of a state. We transformed our variables of revenue receipts and per-capita income in log form to account for the skewness of data. The coefficient denotes that, keeping all other variables in the model constant, an increase in revenue receipts by 1%, leads to a rise in the development expenditure share of the state by 0.08%. The coefficient is observed to be positive and statistically significant.

This suggests that **a revenue shortfall due to the withdrawal of GST compensation may result in a lower share of development expenditure relative to the full compensation scenario.** It is to be noted that this is a result of revenue shortfall irrespective of source of shocks. For example – if instead of GST revenue, there would have been revenue shortfall from State’s total own tax revenue, it would have also resulted in expenditure compression. This implies that, had states continued to receive full compensation post June 2022, share of development expenditure could have been higher than expected under the no compensation scenario. The magnitude of this is reflected in Table 22 for 2023-24, the first full year for which the states, selected for this study, will not receive any compensation.

**Table 22: Impact on development spending as percentage of total expenditure, 2023-24 (In INR Billion)**

2023-24	GST Revenue (Under RUP)	GST revenue (based on buoyancy 1.28)	Likely Shortfall	Percentage Points Change in
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<sup>38</sup> The states are Andhra Pradesh, Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Goa, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Manipur, Mizoram, Nagaland, Odisha, Punjab, Rajasthan, Tamil Nadu, Tripura, Uttar Pradesh, Uttarakhand, West Bengal.

**Development  
Spending/Total  
Spending**

	A	B	C	D
<i>Haryana</i>	434.47	303.26	-131.2	-3.04%
<i>Karnataka</i>	1031.04	671.97	-359.1	-3.62%
<i>Tamil Nadu</i>	849.68	642.88	-206.8	-2.36%

\*Change in development spending shows percentage points change in 'development spending as percentage of total expenditure' due to shortfall in GST collections in 2023-24. GST revenue in column B is based on buoyancy of 1.28.

As noted in Table 22, the impact on share of development expenditure varies between 2.36 percentage points to 3.6 percentage points for three states. With shortfall in GST collections, if we consider 2019-20 development spending estimates, this can translate into reduced development spending to the tune of INR 3,158 crore for Haryana (equivalent to total spending on water supply and sanitation in a year), INR 7,745 crore for Karnataka (equivalent to 1.6 times the total spending on water supply and sanitation in a year) and INR 5,665 crore for Tamil Nadu (equivalent to 2.7 times the total spending on water supply and sanitation in a year).

With respect to per-capita income, the coefficient denoted that, keeping all other variables constant, an increase in per-capita income by 1% in a particular year reduces the need for development expenditure share of the state by 0.11% in that year. The negative sign of the coefficient denotes that a poor state with lower availability of infrastructure and lower levels of education are more inclined to devote a greater share of expenditure to development.

With an increase in the infrastructure index and education index of the state, the development expenditure with respect to the total expenditure of the states falls. For the infrastructure index, the coefficient denoted that an increase in the index value by 0.01 (since infrastructure index lies between 0 and 1) in a year reduces the development expenditure share by 0.24%. This shows that with an increased level of infrastructure level, there is a shift towards the non-development part of the expenditure of the government.

In the education index, the coefficient denoted that with an increase in the education index by 0.01 (since education index lies between 0 and 1) reduces the development expenditure share by 0.009%. Although the coefficient denotes a negative relationship with the dependent variable, the relationship is not statistically significant.

In a nutshell, what this modeling exercise shows is that – a reduction in revenue receipts at the state level, unless fulfilled by some other sources, would have an impact on development expenditure. How the state ultimately allocates the falling revenue share to curtailing of expenditure is more of an art than science. At the same time, states are showing an active interest in asset monetization or mobilizing revenue from non-tax sources. If they are able to do so, then the impact on expenditure of cessation of GST compensation maybe less severe. However, what if the states are unable to garner those revenue? There is a stickiness in some component of expenditure. For example- committed expenditure at the state level. The state has to incur those irrespective of the revenue position. As a result, non-committed expenditure or potential capital expenditure would bear the brunt. This modeling exercise is not a definite estimate and the size of the impact would vary depending upon multiple other factors. However, what remains critical is that – unless the revenue gap is filled, development expenditure is going to face the axe. This is not a very encouraging state of affairs.

## 5. Recommendations

In this section, recommendations emanating from the analysis and discussions with stakeholders are outlined along with potential areas of collaboration opportunities between tax authorities in India and UK government, most specifically, Her Majesty's Revenue and Customs (HMRC). The recommendations are offered bearing the tax administration of the Centre and States in mind. The recommendations do not cover reallocation of revenue collected or on the nature of expenditure of the Centre or States. These areas are listed based on prior research conducted as well as based on improvement areas identified during the consultation with stakeholders.

### 5.1. Easing Compliances

- **Implementing a supplier verification and rating framework:** Currently, buyers cannot claim Input Tax Credit (ITC) until their suppliers have uploaded their GST returns correctly and paid their tax liability on time. This structure of GST compliance creates dependence on vendors to avail ITC. To ease working capital issues due to blocked ITC and create an ecosystem of reliable and compliant suppliers, a supplier rating framework can be created based on their history of timely return filing and tax payments, which is available on the GSTN portal. Such ratings can help buyers give preference to highly rated vendors to safeguard their ITC, while also create an incentive for suppliers to comply with the GST rules.

**Relevant GST Flowchart Stage: Implementing a supplier verification and rating framework will address some of the challenges during Filing of GST Returns and ITC Matching**

- **Risk assessment using data:** There is a need to build capacity in the states to adopt data driven risk assessment methods which will help them to target high-risk cases and deviations in audit, scrutiny of assessments in a better manner. States and zonal officers in Gurgaon (Haryana) and Thiruvananthapuram (Kerala) are already taking steps to integrate technology-based applications to bring efficiency in scrutiny and assessment<sup>39</sup>. More data collection on GST can aid this process as well as handholding on advanced data analytics. While some states have identified parameters to flag deviations and send automated notices to the taxpayer concerned, there is some scope for refining these systems for developing comprehensive risk assessments.

**Relevant GST Flowchart Stage: Risk assessment using data will strengthen the quality and efficiency of GST Audits, Assessment, and scrutiny**

- **Revisiting the overlapping jurisdiction of Centre and States:** Section 6 of the CGST Act provides the power of cross empowerment of State GST officers and Central GST officers, i.e., Central GST officers can have jurisdiction under State GST and vice-versa for processing and grant of refunds. However, this provision has been referred to cover cases relating to investigation also. In order to avoid cases of simultaneous investigations by two authorities on the same issue or same taxpayer, this provision could be revisited, while also creating mechanisms for information exchange between authorities to avoid dual scrutiny and investigation as it casts a disproportionate compliance burden on genuine taxpayers.

**Relevant GST Flowchart Stage: Revisiting the overlapping jurisdiction of Centre and States will be relevant for GST refunds, Audit and Assessment.**

- **Setting up the GST Tribunal and National Appellate Authority for Advance Ruling (NAAAR):** The constitution of the GST Appellate Tribunal, long overdue, will provide taxpayers with access to a higher GST authority for appeals, thereby also reducing the burden on State High Courts who are currently having to deal with matters relating to GST refund or recovery. Similarly, the constitution of the NAAAR will help create centralized advanced rulings and appeals, helping clear the confusion created by conflicting rulings by different state level AAR and AAARs.

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<sup>39</sup> <https://www.cbic.gov.in/resources//htdocs-cbec/chairman-newsletters/newsletter-04Apr2022.pdf>

### **Relevant GST Flowchart Stage: Setting up the GST Tribunal and NAAAR will be relevant for GST Refund**

- **Bringing uniformity across states** – The GST regime overhauled the erstwhile structure by ushering in a common tax structure and uniform laws applicable to all the states, thereby reducing considerable complexity in the indirect tax regime. At the same time, the regime allows for some discretionary powers to reside with the states given the diversity and varied local contexts of each state. However, this balance might need to be reinstated in light of recent moves by state tax authorities, such as Tamil Nadu and Haryana, who are independently issuing their respective audit guidelines and mechanisms for refund processing, etc. which defeat the principle of procedural uniformity under GST. Similarly, the absence of specific guidelines on dealing with various practical scenarios with respect to e-way bills, has resulted in state officials using discretion. Issuing SOPs for commonly encountered issues with e-way bill enforcement can help state officials adopt a uniform approach of dealing with movement of goods within and across states. Furthermore, states like Tamil Nadu have set up an Advisory Council of tax experts and industry leaders to suggest remedial measures after examining various issues in GST faced by taxpayers and revenue authorities. It would be better to have a unified Tax Policy institute of the GST Council rather than have each state come up with their own.

### **Relevant GST Flowchart Stage: Bringing uniformity across states will improve GST Refunds, Audits and Assessment, E-way bill enforcement**

## **5.2. Institutional capacity building**

It has been about five years since the implementation of the GST and the government adopted a systematic training and capacity building program for central and state officials dealing with GST. However, as both taxpayers and officers have adapted to the changing GST environment and learnt its nuances along the way, there are some improvement areas where institutional capacity building can strengthen people, processes, and technology to streamline the challenges that have been documented in earlier sections of this report.

- **Capacity building of state government officials:** Based on stakeholder consultations, we understand that State Tax Authorities have dealt with State specific VAT Laws for more than a decade before GST regime and tend to use the same procedural mindset such as asking for additional documentation, unnecessary scrutiny for granting refunds. Regular trainings can help state officials transition from the VAT mindset towards a more taxpayer friendly GST regime. Imparting technical skills in handling GST processes which are IT-driven is also very critical. Industry and sector specific training modules will enable the State Tax officers to better appreciate the nuances of each sector and tailor their approach accordingly, be it an audit intervention, scrutiny or an investigation under GST. Such trainings would help create an overall shift in mindset from being an enforcer to a facilitator. These trainings can be designed in collaboration with CBIC and National Academy of Customs, Indirect Taxes & Narcotics (NACIN).

### **Relevant GST Flowchart Stage: Training of state government officials will impact overall compliance framework where the taxpayer has a touchpoint with tax officers.**

#### **Potential area for collaboration: Strengthening India's Tax Policy Unit**

With taxation issues becoming increasingly complex, along with states attempting to come up with their own mechanisms to deal with GST procedures and administration, there should be a dedicated tax policy research unit supporting the GST council which provides sustained and innovative research of both a priori and post-facto tax policy and specific tax measures. In India currently, the Tax Policy Council which is assisted by the Tax Policy Research Unit (TPRU) is tasked with research and analysis activity for tax policymaking within the Department of Revenue. Setup in 2016, the TPRU subsumed the Tax Research Unit (TRU) and Tax Policy and Legislation (TPL) wing under the Central Board of Direct Taxes (CBDT) and CBIC, respectively to bring consistency and coherence in tax policy making<sup>40</sup>. It comprises of multi-disciplinary staff such as CBDT and CBIC officials, as well as economists, statisticians, operational researchers, legal experts, etc.

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<sup>40</sup> <https://pib.gov.in/newsite/PrintRelease.aspx?relid=136014>

However, the TPRU is faced with certain issues which are limiting its effectiveness –

- a. The TPRU's focus is usually limited to revenue considerations only and excludes the wider economic impact of tax measures/policy. This could be due to the fact that it is housed within the Department of Revenue and may not have adequate exposure to fiscal and expenditure policy decision-making. The IMF<sup>41</sup> also suggests that a tax policy unit can reap the benefits of a wider perspective by being housed within the Ministry of Finance, outside of, but closely linked to, revenue administration.
- b. Any measures undertaken to strengthen TPRU might be limited by the fact that there is limited focus of in-house research by tax administrators and in practice, tax officials prefer field deputations over a posting with TPRU. The lateral hiring of external researchers within the TPRU in the form of research fellows has been undertaken<sup>42</sup> in the past as well, however, the translation of their research output into decision making and policy remains dependent on the supervisory officer, who is a government tax official.
- c. An external, independent arm could help provide new ideas backed by independent views, while being shielded from political pressures on expected outcomes of increase or decrease in tax collection and the likely economic impact. Such an independent institution could be a totally new and standalone organization. However, an external arm can suffer from limited access to confidential taxpayer data or limited information about impending policy reform proposals<sup>43</sup>.
- d. Workable alternatives that could be considered are as follows-
  - i. Nesting the unit within an existing government-linked, but independent research institution dealing with tax and fiscal issues like National Institute of Public Finance and Policy. This would facilitate joint research by academic researchers and tax officials, with the possibility of tax practitioners and chartered accountants also being thrown into the mix.
  - ii. Retain the TPRU functions within the Ministry of Finance, while outsourcing certain functions such as development of economic models, tax gap study or an economic impact analysis to an independent body which might be lacking within the TPRU<sup>44</sup>. The unit/organization could also serve as an incubation center for new ideas before they are implemented, similar to a sandbox that leading financial institutions have put out to test products before mass rollout.

To arrive at the best approach, deeper analysis would be required by consulting relevant stakeholders at the Centre and state levels on how India's TPRU can be made truly effective and supplemented with additional capacity that is currently lacking. Learnings could be taken from the experience of the UK's Institute of Fiscal Studies, an independent fiscal policy think tank founded in 1969, and recognized as a leading independent macroeconomic research institute.

- **Leverage Behavioural Insights to improve tax administration:** Globally, Behavioural insights are used as a low-cost intervention that tax officials use to improve tax administration. It has applications across the GST touchpoints for the taxpayers as well as tax officials for risk management, fraud detection, audit. UK's Behavioural Insights Team (BIT), or the nudge unit, that began as a government unit but spun-off into a private consulting division. It has several successful examples of using effective and low-cost interventions to improve tax compliance such as modifying the messages of the letters sent to delinquent taxpayers in the UK that are well-known around the world. As an example, "When people were told in letters from HMRC that most people pay their tax on time, it significantly increased payment rates. The most successful message led to a 5-percentage point increase in payments." BIT's collaboration with other countries such as Guatemala<sup>45</sup>,

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<sup>41</sup> IMF, (2017) Fiscal Policy – How to establish a Tax Policy Unit available at <https://www.imf.org/~media/Files/Publications/HowToNotes/howtonote1707.ashx>

<sup>42</sup> <https://dor.gov.in/sites/default/files/TPRU%20proposal.pdf>

<sup>43</sup> IMF, (2017) Fiscal Policy – How to establish a Tax Policy Unit available at <https://www.imf.org/~media/Files/Publications/HowToNotes/howtonote1707.ashx>

<sup>44</sup> Ibid.

<sup>45</sup> <https://blogs.worldbank.org/voices/ongoing-impact-nudging-people-pay-their-taxes>

Indonesia<sup>46</sup> and Canada<sup>47</sup>, resulted not only in an increase in tax collection, but also changed how tax officials thought and acted.

**Relevant GST Flowchart Stage: Behavioural Insights to improve tax administration will improve efficiency in GST collection, and GST return filing for higher compliance**

- **Potential area for collaboration:** In India, the CBDT has been experimenting with the use of behavioural nudges to improve personal income and corporate tax filings in India. This indicates a positive outlook in the Ministry of Finance (MoF) towards behavioural sciences-based interventions to influence taxpayer behaviour and compliance. Therefore, there exists a window of collaborative opportunities for BIT with the MoF and CBIC to work on methods to improve indirect tax compliance and reducing tax evasion.
- **Reorganization of the State tax Departments:** State Tax Authorities have limited manpower where each officer is handling multiple workflows. A comprehensive HR reorganization of the State Tax departments may be explored so as to position them better to render more effective taxpayer services while not losing sight on compliance and enforcement. Such an exercise was undertaken by the 80,000+ strong<sup>48</sup> CBIC of Central GST officials just prior to roll out of GST in 2017 and has paid rich dividends in terms of improving the approach towards taxpayer services such as registrations, refunds etc, while ensuring due importance for leveraging technology towards detection of tax evasion, risk-based scrutiny and investigation/ audit.

**Relevant GST Flowchart Stage: Reorganization of the State tax Departments will strengthen all the stages of GST flowchart which involve taxpayer services such as GST registrations and refunds.**

**Building Data analytics capacity for states:** Periodic exchange of information between government departments yield immediate benefits for fraud investigation and enforcement/audit processes. Therefore, data exchange is critical. However, beyond data sharing, it is important that pooled data analysis can also be synergized. Currently, at the Central level, adequate capacity has been built in the form of Directorate General of Analytics & Risk Management (DGARM) which utilizes internal and external data sources for data mining and functions as an apex body under the CBIC for data analytics and risk management. DGARM was created as a specialized wing under CBIC to cater to the growing need for harnessing data analytics and risk management in a structured way. It handles all data-driven risk management functions under both GST and Customs for CBIC and its field formations. The innovative efforts of DGARM, using AI/ML and other tools have enabled better detection of tax evasion under the GST regime, especially in the area around 'fake invoices' in GST. The DGARM has also been assigned the task of identification of potentially 'risky' taxpayers whose GST returns are to be scrutinized by the CBIC officers. Likewise, the GSTN also has developed some capabilities around Business Intelligence and Fraud Analytics (BIFA) and is poised to develop an advanced analytics platform the Centre and the State Tax Authorities and policymakers.

While GSTN shares the pan India data with CBIC, the data pertaining to the States are shared with the respective State Tax department. This is limited to state data collected on GSTN returns, e-way bills and data collected by National Informatics Centre (NIC). However, limited information is available in public domain about the insights shared by CBIC with the states and the analysis abilities of states in this regard. A few states have begun building in-house capacity to undertake risk profiling and data analytics such as Kerala and Andhra Pradesh<sup>49</sup> but such measures tend to be ad-hoc and outsourced to external consultants. For example, Kerala has identified some risk factors such as high ITC utilization, Mismatches between GSTR-1 and GSTR-3B, turnover below the value of TDS and TCS reported by the taxpayer, etc. which the system flags as a variance and subjects the identified case to additional checks. Some states intend to enhance internal data analytics capacity to detect fraud (e.g., Gujarat). It is crucial that states build greater capacity as they have a significant say in changing the course of indirect tax structure within the broader ambit of GST laws part of the GST council. However, for this, states require data driven analysis and 'what-if' analysis to foresee the impact and outcomes of various scenarios. States thus require some handholding to build

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<sup>46</sup> <https://www.bi.team/publications/encouraging-earlier-tax-returns-in-indonesia/>

<sup>47</sup> <https://www.bi.team/blogs/how-behavioural-insights-helped-canadians-access-their-tax-benefits/>

<sup>48</sup> CBIC Circular available at [https://www.cbic.gov.in/resources/htdocs-cbec/deptt\\_offcr/revised-allocation-field-formations.pdf;jsessionid=396257FAB406BD5A58071DFBC46F633D](https://www.cbic.gov.in/resources/htdocs-cbec/deptt_offcr/revised-allocation-field-formations.pdf;jsessionid=396257FAB406BD5A58071DFBC46F633D)

<sup>49</sup> <https://keralataxes.gov.in/wp-content/uploads/2021/03/Guidelines-Scrutiny.pdf>

systems and processes to use analytics and big data to be able to conduct predictive analysis for compliance, tax gaps, pre-assessment process, fraud detection, dispute management, etc.

- **Relevant GST Flowchart Stage: Building Data analytics capacity for states will impact GST collection, GST refunds, audits, assessment, etc.**

**Potential area for collaboration:** Carefully designed training programmes keeping in mind the local context of the state tax officials are required to build new skillsets such as data analytics. These would need to be adequately complemented with behavioral trainings to bring a shift in mindsets from an enforcer to a facilitator. The expertise of bodies such as the HMRC can be combined with the resources and networks of the Tax Policy Research Unit (TPRU) under the Department of Revenue and National Academy of Customs, Indirect Taxes and Narcotics (NACIN), for setting up such programmes in India. A three-step collaboration process can be considered –

1. Educating state governments through awareness sessions on the possible uses of data analytics, the outcomes that can be achieved and the benefits to be reaped
2. Bringing experts from tax analytics units in the UK and other Commonwealth countries to demonstrate use cases of analytics used successfully in their countries to convince key state stakeholders
3. Providing hand-holding assistance to build tax analytics units in the states – either as an in-house unit or an external unit controlled by the state government.

Some of the techniques that could be covered in the awareness sessions include -

#### **a. Tax analytics techniques for state tax authorities**

State authorities can use three kinds of analytics capabilities<sup>50</sup> :

- **Tax policy/tax rate impact** that would give a sense to the states of the likely impact of changes in various tax rates as well as tax policy/administration mechanism. The tax policy unit would also decipher various aspects of GST laws, circulars, notifications and would educate the officials about it for ease of implementation.
- **Predictive analytics** that can anticipate likely problems – for instance risk profiling of taxpayers with respect ex-ante assessment of accuracy of the submitted tax return or timely payment of due tax liability. This could help the tax administration to judiciously utilize limited resources and conduct targeted interventions.
- **Prescriptive analytics** that can help state tax administrations understand the impact of their actions on taxpayer behaviour, so that authorities can opt for right course of action for any chosen taxpayer or group of taxpayers.

#### **b. Tax gap analysis and tax revenue forecasting**

In India, tax forecasting became an important tool for ensuring long-term macroeconomic stability with the implementation of the Fiscal Responsibility and Budget Management Act, 2003. Tax forecasting is carried out independently, on an annual basis, by the TPL unit in the (CBDT) and the TRU in the CBIC for the taxes they administer. At present, the TPRU is in a nascent stage of developing a micro simulation model for the purpose of tax revenue forecasting<sup>51</sup>. Furthermore, countries like Australia and UK conduct tax forecasting for a much wider purpose than India, where it is only done for fiscal policy formulation, along with increasing compliance<sup>52</sup>.

The HMRC carries out scenario modelling to help quantify the impact of future strategy and policy decisions on tax gap. The processes and methodologies adopted for tax revenue forecasting are structured and well-defined in UK; and the results are made freely available. UK has built deep capabilities in the area of tax forecasting and the HMRC can collaborate with India in imparting training as well as sharing best practices in this regard.

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<sup>50</sup> OECD (2016), Advanced Analytics for Better Tax Administration: Putting Data to Work

<sup>51</sup> ICRIER (2018) Research Based Policy Making in Taxation: Building Revenue Analytics Capacity Following International Best Practices

<sup>52</sup> Ibid

Since the Government of India has a large taxpayer database with various technological development in the past such as GSTN, linking of Aadhar, etc., India can fortify its efforts by exploring similar initiatives undertaken by HMRC in developing such analytical systems which can help increase the tax base and revenue.

### 5.3. Enhancing administrative efficiency

- **Employing technological methods for small value taxpayers:** Voluntary registrations by taxpayers who are otherwise exempt under the GST regime are creating a disproportionate administrative burden on states. With the bulk of the taxpayers falling into the category of less than INR 20 lakhs ( $\approx$  GBP 0.02 Mn), they contribute minimal revenue but require high administrative intervention in the case of fake invoicing and other issues. Voluntary registrations are common in many jurisdictions globally and it is a good practice to ensure formalization of the economy to widen the tax base. To help with administrative efficiency, alternative systems might be devised for dealing with small value taxpayers using technology to automate administrative procedures and use risk-based mechanisms and fraud detection mechanisms.  
**Relevant GST Flowchart Stage: Employing technological methods for small value taxpayers will improve GST registrations and assessment.**
- **Reviving the Sectoral GST Groups under the GST Council:** 18 Sectoral Groups representing various sectors of the economy were constituted by the GST Council to ensure smooth roll-out of GST. These Groups in close coordination with respective industry bodies/ associations helped in smooth implementation by ensuring that issues were timely responded and the problems pertaining to their respective sector(s) were well represented. In order to simplify the current GST framework, it is important to revive these groups as they better understand the sector specific issues and help in resolving them in a time bound manner.  
**Relevant GST Flowchart Stage: Reviving the Sectoral GST Committees under the GST Council will bring on board sector specific compliance issues in GST**
- **Stakeholder consultative mechanism** – In the absence of any formal stakeholder consultative mechanism directly under the GST Council, a suitable Committee be constituted where taxpayers and other stakeholders can put forth their suggestions on a quarterly basis in a structured, documented, and transparent manner to the GST Council for its consideration.  
**Relevant GST Flowchart Stage: Stakeholder consultative mechanism will impact GST Rate policies as well as compliance challenges across the flowchart.**

## Potential area for collaboration: Policy Impact Assessment (PIA)

In India, policy impact analysis is conducted by the TPRU (though there is no dedicated unit within the TPRU to carry out this function) but only for selected tax policy proposals<sup>53</sup>. Ex-ante assessment for new proposals is done only for policies that are presented during the annual financial budget of the government. For every tax proposal to be presented along with the Budget proposal, a revenue forecast analysis (as a result of the additional resource mobilization (ARM)) is done<sup>54</sup>. This is presented to the Parliament. Ex-post analysis of these policies is also conducted to some extent to ascertain whether the proposal has met the projected ARM and identify reasons for the success or failure of the policy. The Government is briefed about the results. In some cases, impact assessment is done by the Parliamentary Standing Committee on Finance on legislative measures. The Comptroller and Auditor General of India (CAG) has also increasingly begun to conduct performance audits and a comprehensive report is prepared and submitted to the Parliament. While these reports help in correcting implementation deficiencies, they are lacking in analysis of the cost of compliance to taxpayers or that incurred by the tax administration<sup>55</sup>.

The far-reaching impact of tax policy necessarily requires a robust policy impact assessment (PIA) process at the Central level. Ex-ante Policy Impact Assessment is an analytical and iterative process, conducted at the early stages of policy-making exercise. It comprises a set of logical steps to support the decision-making process by providing evidence-based policy alternatives, forecasting, and listing their potential impacts. The fourth stage of impact assessment is the most crucial stage which involves assessment of various impacts of the identified policy options. This could involve the following assessments for tax policies under consideration –

- Fiscal Impact Assessment – This stage analyses the budgetary implications of the policy options being considered
- Administrative Impact Assessment – This analyses the administrative implications of policy options which include considerations whether new legislation, creation of public bodies, adjustments to the planning documents, changing existing functions, etc. are needed. These can have crucial implications on the cost, effectiveness, and timelines of the policy options.
- Economic Impact Assessment – This involves estimating the costs and benefits of policy options on the economy in general and economic agents by assessing the impact on competitiveness, productivity, and competition. This also helps ascertain the compliance costs of policy options and their effect on the economy.

Countries like the UK, Canada and Australia have well laid out processes for both ex-ante and ex-poste impact assessment of policies and regulations. Australia made it mandatory for the preparation of a Regulation Impact Statement (RIS) for any regulatory proposal affecting business in 1996. It has a guidebook for policy officers called the 'Users Guide and Quickstart to Regulatory Impact Analysis'<sup>56</sup> to help officers prepare an RIS. A key

**Figure 20 Policy Impact Assessment Steps (at the level of line Ministries)**



<sup>53</sup> ICRIER (2018) Research Based Policy Making in Taxation: Building Revenue Analytics Capacity Following International Best Practices

<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

<sup>56</sup> For details see <https://www.pmc.gov.au/regulation/best-practice-regulation> and [http://regulationbodyofknowledge.dge.org/wp-content/uploads/2013/03/AustralianGovernment\\_Best\\_Practice\\_Regulation.pdf](http://regulationbodyofknowledge.dge.org/wp-content/uploads/2013/03/AustralianGovernment_Best_Practice_Regulation.pdf) (last accessed on December 22, 2017)

principle for Australian Government policy makers in 'The Australian Government Guide to Regulation' is that the cost burden of a new regulation must be fully offset by reductions in existing regulatory burden. It is required that all regulatory costs, whether arising from new regulations or changes to existing regulations must be quantified using the 'Regulatory Burden Measurement' framework. In the UK, HM Treasury has issued a 'Green Book' that outlines the mandate for regulatory impact assessment for all regulations and is to be used for any analysis to support a government decision to adopt a new policy, or to initiate, renew or expand programmes or projects, which would result in measurable benefits and/ or costs to the public<sup>57</sup>. Using the guidance from these best practices, pilot PIAs could be run in India to establish a case for a legislative provisioning for formal Policy Impact Assessment processes in India's tax policy formulation.

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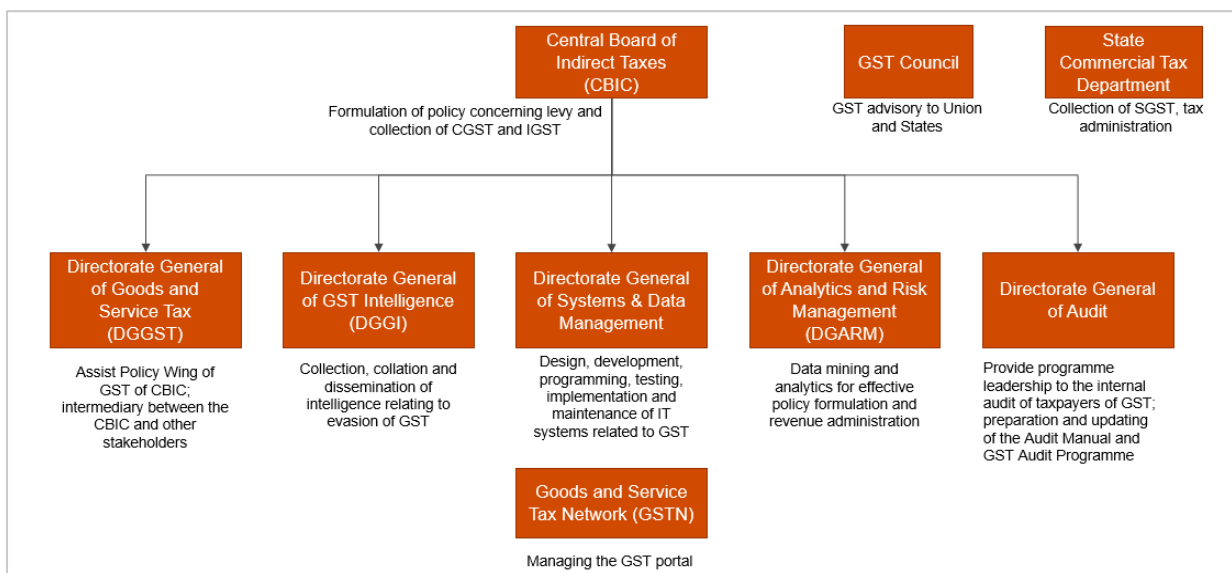
<sup>57</sup> For details see [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/220541/green\\_book\\_complete.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220541/green_book_complete.pdf)

# Appendix

## A. Institutions related to GST administration

There are multiple institutions at the Union Government level as well as State Government level that play an important role in GST administration. This has been presented in Figure 21.

**Figure 21: Institutions related to GST administration**



A brief description of the roles and responsibilities of various institutions have been provided below.

**The GST Council:** It is responsible for the entire architecture of GST. The GST Council comprises of following members:

- Union Finance Minister
- The Union Minister of State, in-charge of Revenue, Min. of Finance
- The Minister In-charge of Finance or Taxation or any other Minister nominated by each State Government

The Council is empowered to make recommendations to the Union and the States on:

- the goods and services that may be subjected to, or exempted from the goods and services tax
- the threshold limit of turnover below which goods and services may be exempted from goods and services tax
- the rates including floor rates with bands of goods and services tax

**Central Board of Indirect Taxes and Customs (CBIC):** CBIC is a part of the Department of Revenue under the Ministry of Finance, Government of India. It deals with the tasks of formulation of policy concerning levy and collection of CGST and IGST.

**Directorate General of Goods and Service Tax (DGGST):** It is an attached office of the CBIC. This office has been entrusted with the task of assisting the Policy Wing of GST of CBIC, developing training modules, research and analysis work, acts as a Think Tank and an intermediary between the CBIC and field formations and coordinates with various Directorates of CBIC, Central Government Ministries/Departments and State/UT Government Ministries/Departments connected to GST and Information Technology.

**Directorate General of GST Intelligence (DGGI):** It is the apex intelligence organisation functioning under the Central Board of Indirect Taxes & Customs. It is entrusted with the task of collection, collation and dissemination of intelligence relating to evasion of Goods and Services Tax (GST).

**Directorate General of Systems & Data Management:** The DG (Systems & Data Management) has been entrusted with the implementation of the projects related to Information & Communication Technology. It is responsible for the design, development, programming, testing, implementation and maintenance of IT systems related to GST.

**Directorate General of Analytics and Risk Management (DGARM):** It is the apex body of CBIC for data analytics and risk management. It utilises internal and external data sources for detailed data mining. Its data and inputs provide a national and sub-national perspective for policy formulation. It works closely with DG Systems and DG Audit for revenue administration.

**Directorate General of Audit:** Its primary function is to develop and provide policy direction and programme leadership to the internal audit of taxpayers of Goods & Service Tax. It is also responsible for effective and efficient implementation, including periodic review, preparation and updating of the Audit Manual and GST Audit Programme.

**State Commercial Tax Department:** It is responsible for collection of SGST as well as administration of GST in the respective states.

**GSTN:** It is a non-profit, non-government organisation which manages the entire IT system of the GST portal.

## B. Key legislations in GST Architecture

S/N	Legislation	Brief Description
1	The Central Goods And Services Tax Act, 2017	Objective: To make a provision for levy and collection of tax on intra-State supply of goods or services or both by the Central Government
2	The Integrated Goods And Services Tax Act, 2017	Objective: To make a provision for levy and collection of tax on inter-State supply of goods or services or both by the Central Government
3	The Union Territory Goods And Services Tax Act, 2017	Objective: To make a provision for levy and collection of tax on intra-State supply of goods or services or both by the Union Territories
4	State-wise Goods and Services Tax Act, 2017	Objective: To Make a Provision for Levy and Collection of Tax on Intra-State Supply of Goods or Services or Both by The State  Objective: To provide for compensation to the States for the loss of revenue arising on account of implementation of the goods and services tax.  Key Components: <ul style="list-style-type: none"> <li>• The projected nominal growth rate of revenue subsumed for a State during the transition period shall be fourteen per cent per annum</li> <li>• For the purpose of calculating the compensation amount payable in any financial year during the transition period, the financial year ending 31st March 2016, shall be taken as the base year.</li> <li>• Base year revenue for a State shall be the sum of the revenue collected by the State and the local bodies during the base year, on account of the taxes levied by the respective State or Union and net of refunds, with respect to the following taxes, imposed by the respective State or Union, which are subsumed into goods and services tax, namely: <ul style="list-style-type: none"> <li>○ the value added tax, sales tax, purchase tax, tax collected on works contract, or any other tax levied by the concerned State under the erstwhile entry 54 of List-II (State List) of the Seventh Schedule to the Constitution</li> <li>○ the central sales tax levied under the Central Sales Tax Act, 1956;</li> <li>○ the entry tax, octroi, local body tax or any other tax levied by the concerned State under the erstwhile entry 52 of List-II (State List) of the Seventh Schedule to the Constitution;</li> <li>○ the taxes on luxuries, including taxes on entertainments, amusements, betting and gambling or any other tax levied by the concerned State under the erstwhile entry 62 of List-II (State List) of the Seventh Schedule to the constitution;</li> <li>○ the taxes on advertisement or any other tax levied by the concerned State under the erstwhile entry 55 of List-II (State List) of the Seventh Schedule to the Constitution;</li> <li>○ the duties of excise on medicinal and toilet preparations levied by the Union but collected and retained</li> </ul> </li> </ul>
5	The Goods and Services Tax (Compensation to States) Act, 2017	

- by the concerned State Government under the erstwhile article 268 of the Constitution;
  - any cess or surcharge or fee leviable under entry 66 read with entries 52, 54, 55 and 62 of List-II of the Seventh Schedule to the Constitution by the State Government under any Act notified under sub-section (4)
- The projected revenue for any year in a State shall be calculated by applying the projected growth rate over the base year revenue (2015-16) of that State. For example: Projected Revenue for 2018-19=100 (1+14/100)<sup>3</sup>
- The actual revenue collected by a State in any financial year during the transition period shall be
  - The actual revenue from State tax collected by the State, net of refunds given by the said State under Chapters XI and XX of the State Goods and Services Tax Act;
  - the integrated goods and services tax apportioned to that State;
  - any collection of taxes on account of the taxes levied by the respective State
- The total compensation payable in any financial year shall be the difference between the projected revenue for any financial year and the actual revenue collected by a State.
- GST Cess: There shall be levied a cess on such intra-State supplies of goods or services or both, and such inter- State supplies of goods or services or both. The list includes:
  - Pan Masala.
  - Tobacco and manufactured tobacco substitutes, including tobacco products
  - Coal, briquettes, ovoids and similar solid fuels manufactured from coal, lignite
  - Aerated waters
  - Motor cars and other motor vehicles principally designed for the transport of persons (other than motor vehicles for the transport of ten or more persons, including the driver), including station wagons and racing cars.

## C. List of stakeholder consultations

**Table 23: Stakeholder list**

S. No.	Stakeholder	Purpose/Scope of discussion	Stakeholder
1	UK firms operating in one of the three states	To gain a micro-level understanding and build a case study on the challenges and opportunities faced by a UK firm under the GST regime.	TESCO Bengaluru
			Spirax-Sarco
			Barclays
			United Kingdom India Business Council (UKIBC)
2	Sector Specific Industry Associations	To understand compliance challenges by sector	Confederation of Indian Industry (CII)
			Indian Drug Manufacturers' Association (IDMA)
			Automotive Component Manufacturers Association of India (ACMA)
			Agro Inputs Manufacturers Association of India (AIM)
3	State level MSME Associations/Council	To understand the state level challenges and opportunities faced by MSME taxpayers under the GST regime and how the next phase of GST administration is expected to impact them as a taxpayer as well as MSME owner in these states	Haryana - Gurgaon Industrial Association (GIA)
			Tamil Nadu: Tamil Nadu Small and Tiny Industries Association
4	GST Commissioner of respective State Governments	To understand the state's perspective on how the GST regime has impacted their finances and developmental spending. Further, the discussion shall focus on what are the expected concerns as the new phase of GST administration kicks in.	Office of Haryana GST Commissioner

## D. Review of Literature

SI No	Paper Name	Author	Dependent Variable	Independent Variable	Result
1	Fiscal Reforms, Fiscal Rule and Development Spending: How Indian States have Performed?	Chakraborty et al (2013)	Government expenditure	Per capita income, per capita income growth rate, FRBM rule dummy, VAT dummy, Intergovernmental transfers, state effect, time effect	Per capita income has a positive and significant effect on the size of total expenditure, whereas growth rate does not have a significant effect on it. It suggests that richer states also have larger government size compared to poorer states. Negative and significant fiscal rule variable indicates that the path of 'spending cuts' is followed by the states to meet the FRBM deficit targets. Among the control variables, only the increases in block transfers contribute to the size of total expenditure positively and significantly.
2	Public spending in developing countries: trends, determination, and impact. Public expenditures, growth, and poverty, 20-55.	Fan, S., Yu, B., & Saurkar, A. (2008)	Government expenditure as a percentage of GDP	Government revenue as a percentage of GDP at previous year, Dummy variable for macroeconomic adjustment in a year, year and country dummies	Macroeconomic adjustments do not adversely affect total government spending. However, when controlled for other variables and disaggregate the analysis into different regions, structural adjustment programs increased total government spending. Structural adjustment programs had different consequences for different sectors. In Africa, governments reduced shares for agriculture, education, and infrastructure, while Asian governments reduced shares for agriculture and health. Education and infrastructure suffered from reduction in government expenditures in Latin America.
3	The determinants of health expenditure-A country level panel data analysis. World Health Organisation. Results for Development Institute	Xu, K., Saksena P. (2011)	Total health expenditure, General government expenditure on health	GDP, demographic structure variables (income levels), TB Prevalence, health system characteristics, share of expenditure over GDP	The results suggest that health expenditure in general does not grow faster than GDP after taking other factors into consideration. There was no difference in health expenditure between tax-based and insurance-based health financing mechanisms.

SI No	Paper Name	Author	Dependent Variable	Independent Variable	Result
34	Financing universal health coverage - effects of alternative tax structures on public health systems: cross-national modelling in 89 low-income and middle-income countries. The Lancet, 386(9990), 274-280	Reeves, A., Gourtsoyannis, Y., Basu, S., McCoy, D., McKee, M., & Stuckler, D. (2015).	Government health expenditure	Tax revenue, taxes on capital gains, profits, and income; consumption taxes on goods and services	Each US\$100 per capita per year of additional tax revenues corresponded to a yearly increase in government health spending of \$9.86 (95% CI 3.92–15.8), adjusted for GDP per capita. This association was strong for taxes on capital gains, profits, and income (\$16.7, 9.16 to 24.3), but not for consumption taxes on goods and services (–\$4.37, –12.9 to 4.11).
45	Determinants of Healthcare Expenditure in Economic Cooperation Organization (ECO) Countries: Evidence from Panel Cointegration Tests.	Samadi, A. H., & Homaie Rad, E. (2013).	Health expenditure	GDP per capita, proportion of population below 15, proportion of population above 65, percentage of private healthcare expenditures relative to total healthcare expenditures, number of physicians per 1000 people, percentage of the people who live in urban regions relative to the total population.	A long-term relationship was found between the health expenditures per capita and GDP per capita, the proportion of population below 15 and above 65 years old, number of physicians, and urbanization. All the variables had short term relationships with health expenditures, except for the proportion of population above 65 years old.
6	Analysis of the linkage between domestic revenue mobilization and social sector spending	USAID, July 2016	Total Expenditure as a % of GDP	Tax Revenue as a % of GDP, Total other revenues as a % of GDP, GDP per capita (PPP), Total Population, Official Aid	After normalizing for GDP, an increase in tax revenues led to greater public expenditure on health. It was estimated that a 10 percent increase in national tax revenue leads to a 17 percent increase in public health expenditure in low-income countries, compared to a 4 percent and a 3 percent increase in lower income and upper middle income countries, respectively.
			Tax Revenue as a % of GDP	GDP per capita (PPP), Total other revenues as a % of GDP, Total Population, Official Aid as a % of GDP, Formal Sector as a % of GDP, Trade as a % of GDP, Governance Index (Polity), Country Dummy, Year Dummy	When normalized for GDP, a 10 percent increase in trade leads to a 4 percent increase in tax revenue in low-income countries and 3 percent in lower middle and overall group. Trade has no impact on tax revenue in case of the upper middle-income group.

SI No	Paper Name	Author	Dependent Variable	Independent Variable	Result
			Public Health Exp (% of GDP)	Tax Revenue (% of GDP), GDP per capita (PPP), Lag Private Health Exp (% of GDP), Lag External Health Assistance (% of GDP), Needy Population, Lag Improved Sanitation, Other Total Revenue (% of GDP), Lag No. of prevalence TB cases,	When normalized for GDP, a 10 percent increase in tax revenue leads to a 3 percent and 2 percent increases in the lower and upper middle-income countries, respectively. Overall, a 10 percent increase in tax revenue leads to a 5 percent increase in the public health expenditure.
7	Modelling the determinants of government expenditure in Nigeria	Adamu Jibir et al. (2019)	Government expenditure	Gross domestic product, Tax revenue, Oil revenue, Public debt, Population, Inflation, Trade openness.	It was found that oil revenue, GDP, population, trade openness, oil price, taxation and inflation are important determinants of the size of Nigeria's government expenditure. The study recommends that the revenue base of the country should be diversified beyond oil sector, strengthening of fiscal and monetary policies to ensure stability in price level and exchange rate, the use of fiscal rule through excess crude oil account should also be strengthened to create buffer against fluctuation in oil price and as well as appropriate population reduction policies should be undertaken to curtail rapid population growth.
8	Determinants of Government Consumption Expenditure: A Panel Data Analysis	Abu S Shonchoy (2010)	Government expenditure	Income level, Trade openness, foreign aid, debt, population fractionalization, size of economy, demographic variables.	The study finds evidence that political, institutional variables and governance variables significantly influence government expenditure. The paper also finds new evidence of Wagner's law which states that peoples' demand for service and willingness to pay is income-elastic hence the expansion of public economy is influenced by the greater economic affluence of a nation (Cameron, 1978). Corruption is found to be influential in explaining the public expenditure of developing countries. On the contrary, size of the economy and fractionalization are found to have significant negative association with government expenditure.

SI No	Paper Name	Author	Dependent Variable	Independent Variable	Result
9	Increasing Public Expenditure: Wagner's Law in OECD Countries	Serena Lamartina, Andrea Zaghini (2011)	Government expenditure	Government expenditure lags, per-capita income with lags	There was evidence that provided indication of a structural positive correlation between public spending and per-capita GDP consistent with Wagner's law. A long-run elasticity of greater than one suggests a more than proportional increase of government expenditures with respect to economic activity. It was also found that the correlation is usually higher in countries with lower per-capita GDP, suggesting that the catching-up period is characterized by a stronger development of government activities with respect to economies in a more advanced state of development.
			Development Expenditure	Per capita income, per capita income growth rate, FRBM rule dummy, VAT dummy, Intergovernmental transfers, state effect, time effect	The income level of a state plays a significant role in determining the size of development expenditure. Fiscal rule dummy has a significant and negative impact on development expenditure, and it suggests that the Indian states have compressed their development expenditure in post FRBM period. Block transfers have a positive and significant impact on development expenditure.
10	What Determines Public Education Expenditures in a Transition Economy?	Verbina et al, 2002	Per capita educational expenditures	Total tax revenue, student-population ratio, and population density	The paper shows that revenue and the student-population ratio have a positive impact on education expenditures while the effect of population density is negative. A few regional variables also show significant impact

## E. Forecasting GST collections with different Tax Buoyancy scenarios

Table 24: Forecasted GST collections using different scenarios of buoyancy (in billion INR)

FY	GST Forecast	States'/UTs' share	Haryana	Karnataka	Tamil Nadu
<b>Buoyancy: 1.28</b>					
2021 - 22	10167	5897	224	496	474
2022 - 23	12005	6963	264	586	560
2023 - 24	13775	7990	303	672	643
2024 - 25	15750	9135	347	768	735
2025 - 26	17986	10432	396	877	839
2026 - 27	20523	11904	452	1001	958
<b>Buoyancy: 1.69</b>					
2021 - 22	10167	5897	224	496	474
2022 - 23	12597	7306	277	614	588
2023 - 24	15053	8731	331	734	703
2024 - 25	17906	10386	394	873	836
2025 - 26	21267	12335	468	1037	992
2026 - 27	25233	14635	556	1231	1178
<b>Buoyancy: 1.95</b>					
2021 - 22	10167	5897	224	496	474
2022 - 23	12984	7531	286	633	606
2023 - 24	15918	9233	350	776	743
2024 - 25	19415	11261	427	947	906
2025 - 26	23638	13711	520	1153	1103
2026 - 27	28749	16674	633	1402	1342

Source: Source: GST Statistics (<https://www.gst.gov.in>) and PwC calculations

Note: GST collection excludes GST Compensation Cess and IGST on imports and State's share includes SGST and IGST Settlement

### Revenue Gap for Haryana

Table 25: Revenue Gap for Haryana as percentage of RUP, SOTR and TR<sup>58</sup>

Year	Gap (% of RUP)			Gap (% of SOTR)			Gap (% of TR)		
	1.28	1.69	1.95	1.28	1.69	1.95	1.28	1.69	1.95
2022-23 (Jul-Mar)	30.2%	26.7%	24.5%	19.9%	17.6%	16.1%	11.8%	10.5%	9.6%

<sup>58</sup> India has a federal structure in which there are constitutional provisions whereby certain taxes are levied and collected by the states themselves. These taxes are termed as state's own tax revenue (SOTR). Tax revenue (TR), on the other hand, is obtained by applying a tax rate to a tax base. Tax revenue consists of taxes collected from both direct tax and indirect tax of the government. This can include collections from income tax, corporation tax, wealth tax, tax on land revenue, etc.

Year	Gap (% of RUP)			Gap (% of SOTR)			Gap (% of TR)		
	Buoyancy								
	1.28	1.69	1.95	1.28	1.69	1.95	1.28	1.69	1.95
2023-24	30.2%	23.7%	19.3%	20.7%	16.3%	13.3%	12.2%	9.6%	7.8%
2024-25	30.0%	20.4%	13.7%	21.4%	14.6%	9.8%	12.4%	8.4%	5.7%
2025-26	29.9%	17.1%	7.8%	22.2%	12.7%	5.8%	12.7%	7.3%	3.3%
2026-27	29.8%	13.7%	1.7%	23.1%	10.6%	1.3%	13.0%	6.0%	0.7%

Source: PwC Calculations, Note: SOTR: State's Own Tax Revenue; TR: Total Revenue

#### Revenue Gap for Karnataka

**Table 26: Revenue Gap for Karnataka as percentage of RUP, SOTR and TR**

Year	Gap (% of RUP)			Gap (% of SOTR)			Gap (% of TR)		
	Buoyancy								
	1.28	1.69	1.95	1.28	1.69	1.95	1.28	1.69	1.95
2022-23 (Jul-Mar)	35.4%	32.2%	30.1%	26.6%	24.2%	22.7%	16.7%	15.2%	14.2%
2023-24	34.8%	28.8%	24.7%	27.6%	22.8%	19.6%	16.9%	14.0%	12.0%
2024-25	34.6%	25.7%	19.4%	29.0%	21.5%	16.3%	17.3%	12.8%	9.7%
2025-26	34.5%	22.6%	13.9%	30.5%	20.0%	12.3%	17.7%	11.6%	7.1%
2026-27	34.5%	19.4%	8.2%	32.2%	18.2%	7.7%	18.1%	10.2%	4.3%

Source: PwC Calculations, Note: SOTR: State's Own Tax Revenue; TR: Total Revenue

#### Revenue Gap for Tamil Nadu

**Table 27: Revenue Gap for Tamil Nadu as percentage of RUP, SOTR and TR**

FY	Gap (% of RUP)			Gap (% of SOTR)			Gap (% of TR)		
	Buoyancy								
	1.28	1.69	1.95	1.28	1.69	1.95	1.28	1.69	1.95
2022-23 (Jul-Mar)	25.2%	21.5%	19.1%	13.9%	11.9%	10.5%	8.6%	7.3%	6.5%
2023-24	24.3%	17.3%	12.6%	14.3%	10.2%	7.4%	8.8%	6.3%	4.6%
2024-25	24.1%	13.7%	6.5%	15.2%	8.6%	4.1%	9.3%	5.3%	2.5%
2025-26	24.0%	10.1%	0.1%	16.1%	6.8%	0.1%	9.8%	4.1%	0.0%
2026-27	23.9%	6.5%	-6.6%	17.2%	4.6%	-4.7%	10.3%	2.8%	-2.8%

Source: PwC Calculations, Note: SOTR: State's Own Tax Revenue; TR: Total Revenue

## F. Regression Results

Variable name	Variable label	Model coefficients
de_te	Development Expenditure (de) / Total Expenditure (te)	- (Dependent Variable)
log(rev_rec)	Log of revenue receipts	0.0846***
log(pci)	Log of per-capita income	-0.111***
Fd	Fiscal deficit as percentage of GSDP	0.00687***
infra_index	Infrastructure index	-0.240***
edu_index	Education index	-0.00881
$\alpha$	Constant	1.094***
s	State dummy	
	Observations	225
	R-squared	0.866

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

## G. Questionnaire

### Questionnaire for Private Sector

#### I. Introduction

PwC has been engaged by the Foreign, Commonwealth & Development Office (FCDO) to conduct a study on the future of GST administration in India. The study is intended towards strengthening and modernizing the overall GST tax administration by identifying the challenges (both policy and structural) faced by taxpayers under the GST regime, especially in the states of Karnataka, Haryana, and Tamil Nadu.

As your organization has been operating in India, we are interested in learning about the experience of your firm in operating under the GST regime and gain a micro-level understanding of the benefits and challenges faced with the implementation of GST regime.

We would like to have the discussion with you on the following areas:

- Learn more about your firm including the goods/services offered and its taxability under GST, your suppliers and customers and the challenges faced by you in dealing with them from GST standpoint
- Understand challenges faced by firms across various stages such as GST registration, invoicing, assessment, payment, refund, audit, appeals, etc.
- Understand the benefits/opportunities for firms post GST roll out
- Understand the support required from Government of India to streamline the GST administration process

The interview will take approximately 30 mins. Your response will be treated in the strictest confidence and only the aggregate information gathered will be shared with FCDO, the beneficiary of the study. Any personally identifiable information shall not be disclosed.

We will take notes during the interview for reference purposes.

## II. Interviewee and Organization

**Section objective:** To learn more about the role of the interviewee; learn about the organization's operations including its core business

Qs 1-4 will be pre-filled before the interview

1. Name of the company –
2. Name and designation of interviewee -
3. We understand that the core business of your company is \_<add sector name>\_\_\_\_\_.
4. Does your company imports/export goods or services from/to other countries?
5. How many registrations does your firm have under GST (including ISD, TDS, TCS, etc.)?
6. We understand that your consolidated annual turnover in India is in the range of \_\_\_\_\_. Which state of India constitutes your highest turnover?
7. If annual turnover is less than INR 5 crores, What is the frequency at which you file GST returns under the new GST return system?
  - a. Quarterly
  - b. Monthly

[Hint: The Quarterly Returns Monthly Payment (QRMP) scheme allows registered taxpayers with an aggregate turnover of up to INR 5 crores to file returns on a quarterly basis and make tax payments on a monthly basis]

1. Have you been operating in India before the GST regime was introduced?

If yes, what are the benefits received by your firm due to GST roll out?

(Prompt scenarios -

- a. Uniformity of tax rates and structures
- b. Eliminating the cascading effect of tax (tax on tax)
- c. Simplified filing procedure, digitized processes
- d. Reduced compliances
- e. Reduction in logistics and warehousing costs (no need to pay tax on inter-state movement of goods)
- f. Regulation of unorganized sector

## II. We would like to understand the ease of compliance with the present GST regime under the following heads.

### 5. GST Registration

**Section objective:** To learn about the challenges faced by taxpayers during registration

1. Are you facing any specific challenges during new GST registration or have you faced any in the recent past? If yes, please elaborate. Have you faced any specific challenges in the states of Karnataka, Haryana and/or Tamil Nadu?
2. Has your GST registration been cancelled in the last 12 months? If yes, please cite the reasons and any challenges involved therein.
  - a. If reply to the above question is Yes, have you been able to restore the registration and did you face any specific challenges in getting the same done?
  - b. Have you faced any challenges due to the cancellation of GST registration of your vendors and/or customers?

## 6. Clarity of rules and regulations

**Section objective:** To learn about the challenges faced by taxpayers in accessing information about GST

1. Do you face difficulties in gaining information and clarity about GST regulations in the following areas? –
  - a HSN/ SAC classification of the goods and/ or services provided by you
  - b Scope of Supply and Levy of Tax- f or e.g., whether your supply is a Composite Supply or a Mixed Supply  

(Composite supply means supply of 2 or more goods or services that are naturally bundled and cannot be separated e.g., air transport and food on board. Mixed supply means a combination of two or more goods or services made together for a single price. Each of these items can be supplied separately.)
  - c Classification of after-sale transaction e.g., extended warranty, after-sales service, AMC, etc.
  - d Time of supply for goods and services  

(According to Section 12 of the GST Act, 2017, the time of supply of goods is the earliest of the following:

    1. The date on which the supplier issues an invoice,
    2. The last date on which he is obliged to issue an invoice.
    3. The date on which the supplier receives the payment.)
  - e Value of Supply
  - f Comprehending frequent changes, circulars and notifications issued by the Government (lack of a master circular or consolidated e-book of changes in GST)
  - g Are there conflicting views/ legal opinions/ advance rulings creating confusion?
  - h Is there any classification or rate issue leading to inverted duty structure?

### c Filing returns and Input tax credit

**Section objective:** To learn about the challenges faced by taxpayers and their value chain while filing and reconciling GST returns and ITC

1. Do you face cash-flow/working capital challenges while filing GST returns or matching of ITC? If yes, what proportion of the same pertains to the following:
  - a. Mismatch with GSTR 2A/ 2B
  - b. Non filing of returns by the vendor
  - c. Late filing by vendor
  - d. Import data not reflected in GSTR 2A/2B
  - e. Non-payment of tax by vendor
  - f. Non-compliance by vendor such as fake invoices, circular trading, etc.
2. Are you facing issues in compliance to Sections 49A and 49B read with Rules 86A, 86B and 88A of the GST legislation?  

(Section 49A deals with Utilization of input tax credit subject to certain conditions, 49B deals with Order of utilization of input tax credit, Rule 86A deals with Conditions of use of amount available in electronic credit ledger, 86B deals with Restrictions on use of amount available in electronic credit ledger and 88A deals with Order of utilization of input tax credit.)

3. In your sector of operations, do you face a challenge of blocked credits where certain inputs are not eligible for ITC? (For e.g., ITC on GST paid for construction services of a factory or warehouse is a blocked credit u/s 17(5) of the GST Act)
4. Please mention if you procure goods/services from unregistered suppliers and what proportion does it constitute of your total procurements? Do you face any challenges with such procurements while filing returns and reconciling ITC?
5. Do you face any challenges with availing ITC on goods offered as gifts, freebies, discounted schemes, buy one-get one, CSR, samples, etc.
6. Any Issues in debit to ITC ledger and then re-credit in case of non-payment to suppliers within 180 days?
7. Do you face challenges with cross-charge of expenses across states?

#### d GST Payments

**Section objective:** To learn about the challenges involved in GST payments

1. Are you able to use accumulated GST credits efficiently to replace GST cash payments? (For e.g. – inability to use ITC balance for payment of GST under reverse charge, disallowance of using ITC to pay GST under Rule 86A of the CGST Rules, 2017 due to belief of fraud)
2. Please share your experience if any, of dealing with GST liability on inter-branch supplies?
3. Are there any challenges you are facing with respect to e-invoicing which has now been made mandatory for businesses with aggregate turnover above INR 20 crore (w.e.f. April 1, 2022)? (E.g., inability to amend errors in e-invoices, issues with reconciliation of e-invoice data on GSTR-1 and the e-way bill portal)
4. Issues in getting benefit of credit notes issued as post-sales discounts, B2C discounts, etc. through the issue of credit notes

#### e Obtaining GST Refund

**Section objective:** To learn more about the challenges associated with different scenarios under which refund can be claimed such as refund of tax paid on exports, refund of input tax credit, refund in case of inverted duty structure, re-credit of ITC in case of rejection of refund, etc. along with their overall mechanism and timelines involved

1. Have you claimed any refund under GST and under which category?
2. Have you faced any challenges in the process of obtaining refunds in the below scenarios?

(Scenarios -

- a Refund of tax paid on exports
- b Refund of unutilized input tax credit (ITC) on exports
- c Refund of excess payment of tax
- d Refund from state due to incorrect place of supply
- e Refund on account of assessment/provisional assessment/appeal/any other order)
- f Re-credit of ITC on rejection of refund
- g Refund held up due to non-matching of bank account on PFMS
- h Refund held up due to non-transmission of invoice details on ICEGATE
- i Refund in case of services
- j Refund on exports made through land borders e.g., Bangladesh, Bhutan, Nepal

- k Refund in credit ledger instead of cash ledger
- l Refund held up because of any Show Cause Notice, Scrutiny, Assessment, Audit pending against the Company
- m Refund application being shuttled between Central Government and State Government officials
- n Refund application being rejected without proper reasons or frivolous reasons
- o Deficiency Memos being issued without any specific issues
- p Tag of 'Risky exporter', if levied, has not been removed even after all paper work has been done

3. What is your experience of interacting with tax officials for facilitating refunds? Please compare your experience across the states of Haryana, Tamil Nadu, and Karnataka.

(in terms of filing of refund application, asking for docs, explaining reasons for rejection if any – reason given as any other, behavioural aspects)

- 4. Did you observe any inconsistency across different States (specifically in Haryana, Tamil Nadu, and Karnataka) in the manner of processing refund applications?
- 5. Have you faced any challenges in obtaining interest for delayed payment of refunds?
- 6. Have you faced any demand against refunds granted because of any investigation by DRI or any other agency?

## g Audits and Assessments

**Section objective:** To learn about the challenges involved in GST audits and assessment, filing of returns

- 1. Have you faced any issue in the process of GST audits and assessments?  
(such as notices, summons, provisional assessments, interpretation of law, scrutiny of returns, simultaneous audits by different authorities, etc.)
- 2. Have you faced issues w.r.t. audit of transitional credits availed in TRAN-1, TRAN-2, TRAN-3 or any other aspects related to transition into the GST regime?
- 3. During audits, have errors been identified in place of supply and have you faced any challenges in this regard?
- 4. Section 6 of the CGST Act provides the power of cross empowerment of State GST officers and Central GST officers, i.e., Central GST officers can have jurisdiction under State GST and vice-versa. Has this phenomenon of dual administration under GST created any challenges for you such as issue of show cause notice and summons from multiple jurisdictions? Have you faced notices from DGGI and Jurisdictional Officers on similar issues?
- 5. Have you faced Notices that-
  - a. do not mention the specific Section or Rule under which the Notice has been issued?
  - b. do not mention the contact details of the officer on the Notice?
  - c. Notices and/ or Orders are not uploaded on the GST portal, or not sent via email

## h Appeals and dispute mechanism under GST

**Section objective:** To learn about the difficulties faced by taxpayers during appeals

- 1. Has your firm ever filed an appeal to the Appellate Authority?

If yes,

- a. Cite the reasons for filing appeals such as interpretation of law, classification, factual disputes etc.
  - b. Highlight the challenges associated with the process of filing appeals with respect to hard copy, personal hearing, pre-deposits, etc.
2. How has the absence of a GST Appellate Tribunal impacted your company?
  3. Have you ever applied for an Advance Ruling? How useful do you find the system of advance rulings?
  4. Can you comment on the extent to which an effective grievance redressal mechanism such as the GSTN help desk is available to taxpayers and the time taken to resolve grievances?

**i E-way bills and movement of goods**

1. What has been your experience with the e-way bill under the GST regime versus the earlier regime?
2. Do you face any issues w.r.t. e-way bills in case of the following?
  - a. Transportation through multi-modal transportation
  - b. Transportation through railways, airlines, waterways, public transport, private vehicles, pipelines, etc.
  - c. Transportation of Over-Dimensional cargoes
  - d. Transportation of articles over multiple consignments
  - e. Continuous supply of goods
  - f. Transportation through Challans, Bill-To-Ship-to model, return of goods, transportation between branches in same state, goods sent on approval basis, etc.
3. In case you have experienced detention or seizure of goods and/ or conveyance, what has been your experience in getting the same released, especially in the states of Karnataka, Haryana and/or Tamil Nadu?
4. Do you face any challenges with enforcement officers enroute, especially in the states of Karnataka, Haryana and/or Tamil Nadu?

**j Digitisation of processes**

**Section objective:** To learn about the experience of taxpayers with the technological interface of GST

2. What has been your experience with using the GST Common portal for the various compliances in the GST flowchart? Do you face any challenges while –
    - a. filing of returns,
    - b. filing of appeal,
    - c. filing for refund
  3. What has been your experience with using the E-way bill site?
  4. What has been your experience with using the E-invoice site?
- e. **k. If you are an importer or exporter**, what challenges have you faced with GST? (Refunds on exports, reverse charge mechanism of imports, deemed exports, issues of being identified as a risky exporter)
- f. **Other challenges –**

**Section objective:** To learn about the experience of taxpayers with the miscellaneous procedural aspects of GST

1. Issues with the implementation of Pure-Agent concept in GST

2. What has been your experience with the compliance with job-work under GST?
3. Issues w.r.t. margin scheme, if availed, by your company
4. Transfer of IT in cases of sale, amalgamation, merger, etc.

### III. Suggestions for streamlining GST administration

**Section objective:** To understand the expectations of the firms from Government of India to address the various challenges faced with respect to GST administration

1. What role can technology play in bringing more efficiency in the GST flowchart? Are there any manual processes that can be computerized or any datasets which can be leveraged to streamline GST administration?
2. Any concerns that can be addressed by State Governments to ease GST compliance (e-way bill, checking of vehicles, etc.)?
3. Any views on steps that can be taken by the government to reduce tax evasion and widen the tax base?

## Questionnaire for State Governments

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### I. Introduction

PwC has been engaged by the Foreign, Commonwealth & Development Office (FCDO) to conduct a study on the future of GST administration in India. The study is intended towards strengthening and modernizing the overall GST tax administration by identifying the challenges (both policy and structural) faced by State tax authorities and taxpayers under the GST regime. The objective of the questionnaire is to understand from State officials/solicit their views on challenges faced, feedback on the overall GST compliance processes.

### II. We would like to understand the ease of compliance with the present GST regime under the following heads.

#### a. GST Registration

1. What is your assessment about the current GST registration process?
2. What are the things you believe would need to be simplified to improve GST registration?
3. Are there any administrative changes that you foresee could be done at the State level that could lead to more GST registrations?
4. With the process simplification and administrative reform, in your perspective how much additional revenue it could fetch? 1-5%, 5% to 10%, 10% to 15% and more than 15%

#### b. Clarity of rules and regulations

1. In your assessment, what are the potential areas where more clarity is needed in interpretation of GST related rules and regulations?
2. Could you suggest a few reform measures to be introduced to improve clarity of rules and regulations?
3. In your opinion what would be approximate reduction in number of appeals and disputes due to increased clarity in rules and regulations? 1-5%, 5% to 10%, 10% to 15% and more than 15%
4. Could you comment on the time and cost benefits due to reduction in number of disputes?

#### c. Filing returns

- What is your assessment about the current GST return filing process?
- What are the key reforms you believe are needed to be introduced to increase timely filing of GST returns?

- With the introduction of aforementioned reforms, do you have any estimate of the increase in returns the reforms would lead to? How much additional revenue (in percentage) would it fetch to the Government?
- d. Input tax credit**
- In your assessment, what are the key challenges related to input tax credit?
  - What are the various reform measures to be introduced to improve claiming of input tax credit?
- e. GST Payments**
1. What is your assessment about the current GST Payments process? Is it efficient or is there some scope for improvement?
  2. Based on your experience, what are the top challenges faced by taxpayers & tax authorities in GST payments?
  3. What are the various reform measures to be introduced to improve GST payment processes?
  4. With the introduction of these reforms, do you have any estimate of how much additional revenue it could fetch? 1-5%, 5% to 10%, 10% to 15% and more than 15%
- f. Obtaining GST Refund**
- What is your experience regarding the GST Refund process that tax officials and taxpayers go through?
  - Could you highlight the prominent challenges faced by tax officials and taxpayers while obtaining/processing refund?
  - Are there any administrative changes that you foresee could be done in the state that would address the aforementioned challenges?
- g. Audits and Assessments**
- What are the top issues noticed through the audits? Please suggest a few reforms that could be undertaken by the Government to help taxpayers provide correct information in their next filings.
  - What are the reform measures planned to be introduced to improve auditing processes?
- h. Appeals and dispute mechanism under GST**
- Can you comment on the extent to which an effective grievance redressal mechanism such as the GSTN help desk is available to taxpayers and the time taken to resolve grievances?
  - How effective is the Appeal and dispute mechanism? What are the top challenges you have come across in this?
  - Could you suggest a few reforms that could be introduced in this area?
- i. E-way bills and movement of goods**
- What has been your experience with the e-way bill under the GST regime versus the earlier regime?
  - What are the key challenges associated with e-way bills and what reforms are required to be introduced to address these challenges?
- j. Digitisation of processes**
- Please comment on the digitization process that has been witnessed during the GST regime (GST Common Portal).
  - Please suggest a few reforms that could be introduced to improve ease of doing business for businesses in India.

- What role can technology play in bringing more efficiency in the GST flowchart? Are there any manual processes that can be computerized or any datasets which can be leveraged to streamline GST administration?
- Among the various reforms discussed above, which are the most critical reforms in your opinion? How much impact these reforms can make on revenue collections, 1-5%, 5% to 10%, 10% to 15% and more than 15%?
- Are there any specific challenges for assessing returns filed from the following categories of firms/tax payers?
  - a. Importer/exporter
  - b. Companies in the following sectors:
    - E-commerce
    - Healthcare
    - Advanced engineering
    - Automobile
    - Agriculture
    - Finance

**k. Capabilities of State Government**

- Could you suggest any capacity development requirements for GST officers in the State that will help drive overall tax administration efficiency? This can be across technical and soft skills
- Could you comment on the Data Analytical capabilities of the State and gaps/scope for improvement. The Data Analytical skills are intended to help officers arrest fraud, tax evasion, risk Profiling, etc.

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